(8)

SUPREME COURT, U.S.
FILED
Feb 4, 2002
[redacted] 2002
CLERK

No. 01-147

IN THE

Supreme Court of the United States

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

CHARLES ZANDFORD,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

BRIEF FOR THE RESPONDENT

ROY T. ENGLERT, JR.
ROBBINS, RUSSELL, ENGLERT, ORSECK & UNTEREINER, LLP
1801 K Street, N.W.
Suite 411
Washington, D.C. 20006
(202) 775-4503

STEVEN H. GOLDBLATT *
ABIGAIL V. CARTER
WENDY M. MARANTZ
APPELLATE LITIGATION PROGRAM
GEORGETOWN UNIVERSITY LAW CENTER
111 F Street, N.W.
Suite 123
Washington, D.C. 20001
(202) 662-9555

* Counsel of Record

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

BEST AVAILABLE COPY

64 pp

QUESTION PRESENTED

Whether proof that a stockbroker liquidated positions in a discretionary investment account and then converted the proceeds to his own use, without more, establishes fraud "in connection with" a sale of securities within the meaning of § 10(b) of the Securities Exchange Act of 1934.

TABLE OF CONTENTS

Statute and Rule Involved 1
Statement 1
Summary of Argument 6
Argument 9
I. Section 10(b) Addresses Specific Forms of Market Manipulation and Deception by Any Person and Is Not a Catch-All Provision for All Instances of Broker Misconduct .. 9
A. The Language Congress Used in § 10(b) Confirms that the Provision Serves an Important, but Limited, Purpose in the Regulation of Securities Fraud 11
1. "In Connection With" Specifies a Close Relationship Requiring that a Fraud Pertain to a Securities Transaction, Not Vice Versa 11
2. Considered in Comparison with Other Statutory Provisions, § 10(b)'s Language Does Not Cover All Instances of Broker Conversion 13
B. The Act Codifies Congress's Plan for Self-Regulation Combined with Government Oversight, in Which § 10(b) Plays a Limited Role 14
C. Recognition that § 10(b) Does Not Reach All Instances of Broker Conversion Does Not Leave a Gap in the Regulation of Brokers 20
II. The Court of Appeals Correctly Held that Conversion of the Proceeds of a Sale of Securities, Without More, Does Not Violate § 10(b) 22
A. Conversion of the Proceeds of a Sale of Securities Is Not Deception "In Connection With" a Securities Transaction 23
B. Contrary to the SEC's Claim, Showing Any Nexus Between a Deception and a Securities Transaction Does Not Satisfy the "In Connection With" Requirement of § 10(b) 29
III. The Court of Appeals's Conclusion that Zandford's Sales of Securities Were Authorized and Did Not Violate § 10(b) Is Consistent With this Court's Decision in *O'Hagan* 34
A. The Sales of Securities Did Not Consummate Zandford's Fraud 37

B. The Other Factors Underlying this Court's Holding in *O'Hagan* Are Not Present Here 41
IV. The SEC's Interpretation Is Not Entitled to *Chevron* Deference 42
A. Both this Court and the SEC Have Traditionally Understood that the SEC's Interpretation Is Not Entitled to *Chevron* Deference 42
B. The Sources on Which the SEC Relies Do Not Constitute an Authoritative Agency Interpretation 45
Conclusion 48
Appendix 1a
§ 2, 15 U.S.C. § 78b. Necessity for regulation 1a
§ 9, 15 U.S.C. § 78i. Manipulation of security prices
(a) Transactions relating to purchase or sale of security 2a
§ 15, 15 U.S.C. § 78o. Registration and regulation of brokers and dealers
(b) Manner of registration of brokers and dealers 5a
(c) Use of manipulative or deceptive devices; contravention of rules and regulations 6a
§ 15A, 15 U.S.C. § 78o-3. Registered securities associations
(b) Determinations by Commission requisite to registration of applicant as national securities association 9a
§ 19, 15 U.S.C. § 78s. Registration, responsibilities, and oversight of self-regulatory organizations
(b) Proposed rule changes; notice; proceedings 10a
(c) Amendment by Commission of rules of self-regulatory organizations 13a
§ 21, 15 U.S.C. § 78u. Investigations and actions
(d) Injunction proceedings; authority of court to prohibit persons from serving as officers and directors; money penalties in civil actions 14a
(e) Mandamus 15a
(f) Rules of self-regulatory organizations 16a

TABLE OF AUTHORITIES

Cases

Aaron v. SEC, 446 U.S. 680 (1980) 10, 19, 43
ABF Freight System, 304 N.L.R.B. 585 (1991) 46
ABF Freight System, Inc. v. NLRB, 510 U.S. 317 (1994) 46

Abrams v. Oppenheimer Gov't Sec., Inc., 737 F.2d 582 (7th Cir. 1984) 30
Adamo Wrecking Co. v. United States, 434 U.S. 275 (1978)) 47
Adams Fruit Co. v. Barrett, 494 U.S. 638 (1990) 42, 44
Alley v. Miramon, 614 F.2d 1372 (5th Cir. 1980) 30
Allico Nat'l Corp. v. Amalgamated Meat Cutters, 397 F.2d 727 (7th Cir. 1968) 28
Amalgamated Clothing & Textile Workers Union v. SEC, 15 F.3d 254 (2d Cir. 1994) 46
Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939 (3d Cir.), *cert. denied*, 474 U.S. 935 (1985) 33
Armstrong v. McAlpin, 699 F.2d 79 (2d Cir. 1983) 33
Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 651 F.2d 615 (9th Cir. 1981) 33
Basic Inc. v. Levinson, 485 U.S. 224 (1988) 43
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 11, 17
Bob Evans Farms v. NLRB, 163 F.3d 1012 (7th Cir. 1998) 45
Bochicchio v. Smith Barney, Harris Upham & Co., 647 F. Supp. 1426 (S.D.N.Y. 1986) 25
Bowen v. Georgetown Univ. Hosp., 488 U.S. 204 (1988) 47
Brown v. Ivie, 661 F.2d 62 (5th Cir. 1981), *cert. denied*, 455 U.S. 990 (1982) 30
Burlington Truck Lines, Inc. v. United States, 371 U.S. 156 (1962) 48
Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969) 27
Carras v. Burns, 516 F.2d 251 (4th Cir. 1975) 33
Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) 43, 48
Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930 (2d Cir. 1984), *cert. denied*, 469 U.S. 884 (1984) ..... *passim*
Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984) ..... *passim*
Chiarella v. United States, 445 U.S. 222 (1980) 17
Congregation of the Passion, Holy Cross Province v. Kidder - Peabody & Co., 800 F.2d 177 (7th Cir. 1986) 26
Cooper v. North Jersey Trust Co., 226 F. Supp. 972 (S.D.N.Y. 1964) 28, 45
Costello v. Oppenheimer & Co., 711 F.2d 1361 (7th Cir. 1983) 33
Egelhoff v. Egelhoff, 532 U.S. 141, 121 S. Ct. 1322 (2001) 32

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 11, 17, 18, 44
Fey v. Walston & Co., Inc., 493 F.2d 1036 (7th Cir. 1974) 33
Flickinger v. Harold C. Brown & Co., 947 F.2d 595 (2d Cir. 1991)..... 25
Henricksen v. Henricksen, 486 F. Supp. 622 (E.D. Wis. 1980)..... 27
Herman & MacLean v. Huddleston, 459 U.S. 375 (1983)..... 29
Holly Farms Corp. v. NLRB, 517 U.S. 392 (1996) 46
Imco Poultry, 202 N.L.R.B. 259 (1973)..... 46
In re Ames Dept. Stores Inc. Stock Litig , 991 F.2d 953 (2d Cir. 1993)..... 31
In re Fin. Corp. of America Shareholder Litig., 796 F.2d 1126 (9th Cir. 1986) 31
Kas v. Fin. Gen. Bankshares, Inc., 796 F.2d 508 (D.C. Cir. 1986) 39
Keller v. Halsey, 202 N.Y. 588, 95 N.E. 634 (1911)..... 37
Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350 (1991)..... 43
Langley v. FDIC, 484 U.S. 86 (1987)..... 38
Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116 (1990) 45
Mansbach v. Prescott, Ball, & Turben, 598 F.2d 1017 (6th Cir. 1979).....27, 30
Marbury Mgmt., Inc. v. Kohn, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980) 33
Marine Bank v. Weaver, 455 U.S. 551 (1982)..... 18
Mihara v. Dean Witter & Co., 619 F.2d 814 (9th Cir. 1980)..... 34
Moss v. Morgan Stanley Inc., 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984) 14
Mullen v. J.J. Quinlan & Co., 195 N.Y. 109, 87 N.E. 1078 (1909) 37
New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645 (1995)..... 32
O'Brien v. Cont'l Illinois Nat'l Bank & Trust Co., 593 F.2d 54 (7th Cir. 1979) 26, 27
Okstulski v. Dominick & Dominick, 96-CV-604 (D. Md. filed Feb. 28, 1996)..... 20
Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981) 39
Press v. Chemical Inv. Servs. Corp., 166 F.3d 529 (2d Cir. 1999) 33
Pross v. Katz, 784 F.2d 455 (2d Cir. 1986).....24, 25, 39, 40

Richardson v. MacArthur, 451 F.2d 35 (10th Cir. 1971) 27
Rubin v. United States, 449 U.S. 424 (1981)..... 24
Santa Fe Indus. v. Green, 430 U.S. 462 (1977).....17, 31, 39
SEC v. Adler, 137 F.3d 1325 (11th Cir. 1998)..... 46
SEC v. Drysdale Sec. Corp., 785 F.2d 38 (2d Cir.), *cert. denied*, 476 U.S. 1171 (1986) 24, 25
SEC v. Jakubowski, 150 F.3d 675, 680 (7th Cir. 1998), *cert. denied*, 525 U.S. 1103 (1999).....26, 33
SEC v. Lawson, 24 F. Supp. 360 (D. Md. 1938)..... 45
SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082 (2d Cir. 1972) 27
SEC v. Sloan, 436 U.S. 103 (1978) 47
SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).....23, 43
Shaw v. Delta Air Lines, Inc., 463 U.S. 85 (1983)..... 32
Sherman v. State, 124 Tex. Crim. 205, 61 S.W.2d 488 (1933) 37, 38
Silver v. New York Stock Exchange, 373 U.S. 341 (1963)....10, 15, 21
Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735 (1996)..... 47
Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971), *rev'g*, 430 F.2d 355 (2d Cir. 1970) ..... *passim*
Taussig v. Hart, 58 N.Y. 425 (1874)..... 37
Touche Ross & Co. v. Redington, 442 U.S. 560 (1979)..... 10
TRW Inc. v. Andrews, 122 S. Ct. 441 (2001) 12
United States v. Falcone, 257 F.3d 226 (2d Cir. 2001) 35
United States v. Kendrick, 692 F.2d 1262 (9th Cir. 1982), *cert. denied*, 461 U.S. 914 (1983)..... 27
United States v. Mead Corp., 533 U.S. 218, 121 S. Ct. 2164 (2001) ..... *passim*
United States v. Naftalin, 441 U.S. 768 (1979) 24, 29, 33
United States v. O'Hagan, 521 U.S. 642 (1997)..... *passim*
Wharf (Holdings) Ltd v. United Int'l Holdings, Inc., 532 U.S. 588, 121 S. Ct. 1776 (2001) 31, 40

Statutes and Regulations

§ □2, 15 U.S.C. § 78b 1, 14, 16
§ □5, 15 U.S.C. § 78e..... 15
§ □6, 15 U.S.C. § 78f 22
§ □6(a), 15 U.S.C. § 78f(a)..... 16
§ □6(b), 15 U.S.C. § 78f(b).....20, 21, 22
§ □6(d), 15 U.S.C. § 78f(d) 16

§ □7, 15 U.S.C. § 78g 14
§ □8(b), 15 U.S.C. § 78h(b) 14
§ □9, 15 U.S.C. § 78i 18, 19
§ □9(a), 15 U.S.C. § 78i(a) 1, 18
§ 10, 15 U.S.C. § 78j 18, 19
§ 10(a), 15 U.S.C. § 78j(a) 18
§ 10(b), 15 U.S.C. § 78j(b) ..... *passim*
§ 11(a), 15 U.S.C. § 78k(a) 26
§ 14(e), 15 U.S.C. § 78n(e) 44
§ 15, 15 U.S.C. § 78o 22
§ 15(b), 15 U.S.C. § 78o(b) 1, 13, 22
§ 15(c), 15 U.S.C. § 78o(c) 1, 17
§ 15A(b), 15 U.S.C. § 78o-3(b) 1, 20, 22
§ 19(b), 15 U.S.C. § 78s(b) 1, 20
§ 19(c), 15 U.S.C. § 78s(c) 1, 17, 21
§ 21(d), 15 U.S.C. § 78u(d) ..... *passim*
§ 21(e), 15 U.S.C. § 78u(e) 1
§ 21(f), 15 U.S.C. § 78u(f) 1, 17, 20, 21
§ 21A, 15 U.S.C. § 78u-1 22
§ 28(e), 15 U.S.C. § 78bb(e) 26
§ 32(a), 15 U.S.C. § 78ff(a) 22, 44
Act of Aug. 20, 1964, Pub. L. No. 88-467, 78 Stat. 571 § 6(b) 13
Commodities Exchange Act § 4b(a), 7 U.S.C. § 6b(a) 14
Commodities Exchange Act § 4o(1), 7 U.S.C. § 6o(1) 14
Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq* 32
Fraud by wire, radio, or television, 18 U.S.C. § 1343 2
Investment Advisors Act § 206, 15 U.S.C. § 80b-6 14
Maloney Act of 1938, Pub. L. No. 719, 52 Stat. 1070 (1938) 15, 22
Securities Act § 17(a), 17 U.S.C. § 77q(a) 3, 24
17 C.F.R. 240.10b-5 (SEC Rule 10b-5) ..... *passim*

SEC Releases

Kenneth Leo Bauer, Exchange Act Release No. 4,006 (1947) 46
Southeastern Sec. Corp., Exchange Act Release No. 4,274 (1949) 46

Miscellaneous

Barbara Bader Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101 (1984) 35
Brief for the SEC, *SEC v. Zandford*, 238 F.3d 539 (4th Cir. 2001) (No. 99-1733) 23
Brief for the United States, *United States v. O'Hagan*, 521 U.S. 642 (1997) (No. 96-842) 44
Bergen Evans & Cornelia Evans, *A Dictionary of Contemporary American Usage* (1957) 12
Federal Bar Association Securities Law Committee, Federal Securities Laws Legislative History 1933-1982 (1983) 15, 17
H.W. Fowler, *A Dictionary of Modern English Usage* (2d ed. 1965) 12
Thomas Lee Hazen, *Law of Securities Regulation* (3d ed. 1996) 46
Hearings on H.R. 7852 and H.R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong. (1934) 17, 18
Roberta S. Karmel, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor*, 61 Law & Contemp. Prob. 33 (1998) 47
Edmund W. Kitch, *A Federal Vision of the Securities Laws*, 70 Va. L. Rev. 857 (1984) 18
Donald C. Langevoort, *Corporate Accountability: Seeking Sunlight in Santa Fe's Shadow*, 79 Wash. U. L.Q. 449 (2001) 39
Louis Loss, *Fundamentals of Securities Regulation* (1st ed.1983) 31
Louis Loss & Joel Seligman, *Securities Regulations* (3d ed. 1991) ..... *passim*
Lewis D. Lowenfels & Alan R. Bromberg, *Rule 10b-5's "In Connection With": A Nexus for Securities Fraud*, 57 Bus. Law. 1 (2001) 28
Charles H. Meyer, *The Law of Stockbrokers and Stock Exchange* (1931) 37
National Association of Securities Dealers, Inc., NASD Manual (CCH) (2001) 13, 21, 26

Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 Yale J. on Reg. 149 (1990) 47
Restatement (Second) of Contracts (1979) 38
S. Rep. No. 73-1455 (1934) 15, 19
S. Rep. No. 73-792 (1934) 15, 16, 21
S. Rep. No. 94-75 (1975) 17
John E. Tracy & Alfred Brunson MacChesney, *The Securities Exchange Act of 1934*, 32 Mich. L. Rev. 1025 (1934) 19

STATUTE AND RULE INVOLVED

All sections herein refer to the Securities Exchange Act of 1934 (the Act), 15 U.S.C. § 78a *et seq.*, unless otherwise noted. The texts of § 10(b) and Rule 10b-5 are reproduced in the appendix to the petition for a writ of certiorari. Pet. App. 52a-53a. The texts of §§ 2, 9(a), 15(b) and (c), 15A(b), 19(b) and (c), and 21(d), (e) and (f) are reproduced in relevant part in the appendix. Resp. App. 1a-16a.

STATEMENT

This case requires this Court to determine whether a stockbroker's conversion of money, including proceeds from the sales of securities in a client's discretionary investment account, violates § 10(b) and Rule 10b-5. The parties agree that the outcome turns on the proper interpretation of § 10(b)'s requirement that a deception be "in connection with" a securities transaction. This case arises in the following setting:

1. In January 1991, the National Association of Security Dealers (NASD), "pursuant to its self-regulatory duties," conducted "a routine examination" of Dominick & Dominick, a brokerage firm located in Bethesda, Maryland. Pet. App. 34a.[1] The NASD "inadvertently discovered" that money had been transferred on more than twenty-six separate occasions from an investment account of William Wood and his daughter Diane Okstulski (the Woods) to accounts controlled by Charles Zandford or held in Zandford's name. Pet. App. 34a. The Woods set up the account with Zandford as their broker in November 1987. By March of 1988, they had committed funds totaling

[1] The facts summarized here are taken from the opinion of the court of appeals affirming Zandford's wire fraud conviction and the superseding indictment, upon which the SEC relied when it moved for summary judgment.

$419,255 to the account. Pet. App. 41a. By September 28, 1990, Zandford had caused the balance in the account to be depleted. Pet. App. 41a. When confronted about the transfers in early 1992, Zandford acknowledged that the money had been transferred to him. He explained that the money was transferred pursuant to three agreements he had entered into with the Woods in 1988 and 1989—a personal services agreement, an agreement to invest in a business, and an unsecured personal loan. Pet. App. 34a.

In April 1995, a federal grand jury in the United States District Court for the District of Maryland indicted Zandford, charging him with thirteen counts of wire fraud in violation of 18 U.S.C. § 1343. Pet. App. 35a. The indictment alleged that Zandford "caused checks to be issued against the security positions of [the Woods]" and "sold securities in [the Woods'] joint investment account . . . and then made personal use of the money." Pet. App. 41a-42a. Each of the thirteen counts of the indictment charged Zandford with causing a wire transfer to be made between Maryland and New York in executing the scheme. Pet. App. 40a-50a. With the exception of a reference in the indictment to the purchase of shares in the Colonel Tax-Exempt Insured Mutual Fund, Pet. App. 42a, the record does not establish what securities were bought or sold at any time.[2]

---

[2] Based on allegations in its civil complaint, the SEC refers to sales of mutual fund shares from a mutual fund account. Pet. Br. 14. This allegation and others in the complaint were not alleged in the criminal wire fraud indictment and were not relied on by the SEC when it moved for summary judgment. The SEC contends that, because the court of appeals dismissed the case outright, this Court should review the entire record, not just the summary judgment papers, to determine whether the SEC established a § 10(b) violation. Pet. Br. 7 n.2. Respondent has taken the position that the record under review is the summary judgment record and the question is whether that record, viewed in the light most favorable to the SEC, states a § 10(b) violation. Br. in Opp. 10-12.

Zandford was convicted by a jury on all counts, sentenced to fifty-two months in prison, and ordered to pay $10,800 in restitution. Pet. App. 2a. On appeal, he argued, among other things, that there was insufficient evidence of a scheme to defraud because the Woods had voluntarily transferred their money to him via the three lawfully executed agreements. Pet. App. 36a-37a. In addressing the sufficiency of the evidence to convict, the court concluded that it was sufficient for the government "to cast doubt upon the validity of the agreements or demonstrate that the agreements themselves manifested the scheme by which Zandford tried to 'legitimize' the wholesale theft of the Woods' money." Pet. App. 36a. The court pointed to various factors, including the Woods' mental and physical limitations, the transfer of large sums of money from the investment account to Zandford's own accounts, the fact that the fraudulent agreements were contrary to the Woods' conservative investment objectives, and the fact that the agreements violated the rules of NASD and Zandford's employer. Pet. App. 36a-37a.

2. In September of 1995, the SEC filed the civil complaint in this action under § 10(b) of the Act and Rule 10b-5 and § 17(a) of the Securities Act of 1933. Pet. App. 25a.

In April of 1998, the SEC moved for partial summary judgment based exclusively on collateral estoppel. Pet. App. 3a, 16a-17a. It asserted that the facts established by the criminal judgment also established civil securities fraud and that Zandford was estopped from contesting those facts. Zandford moved to conduct limited discovery on the issue

---

The court of appeals's decision makes clear that the court considered only the investment account. Pet. App. 14a. At this juncture, however, this dispute between the parties is inconsequential because the reference to the mutual funds is not critical to the analysis.

of whether his fraud was "in connection with" a securities transaction. Pet. App. 3a.

On March 2, 1999, the district court denied Zandford's discovery request and granted the SEC's motion for partial summary judgment.[3] Pet. App. 3a, 17a-18a. The district court granted summary judgment because it believed that Zandford's "criminal conviction was based on the same facts alleged by the Commission against Zandford . . . and that Zandford is therefore collaterally estopped from relitigating the facts underlying his conviction." Pet. App. 22a; Pet. App. 16a-17a.

3. The court of appeals reversed and held that collateral estoppel did not bar relitigation of any issue of law because Zandford's conviction for wire fraud did not require a determination of whether his "fraud was sufficiently connected to a securities transaction." Pet. App. 5a. That ruling is not contested here.

In the next portion of its opinion, relevant to the issue now before this Court, the court of appeals reviewed the district court's legal conclusion that "in this case," Zandford's sales of "securities as part of a scheme to misappropriate proceeds . . . satisf[y] the 'in connection with' requirement." Pet. App. 5a.

The court of appeals preliminarily observed that "[t]he federal securities laws do not cover all types of fraud.

---

[3] The SEC had reserved from the motion for partial summary judgment the claims of excessive trading, or churning, which it acknowledged were not addressed by the criminal conviction and thus could not be resolved by invoking collateral estoppel. Opp. App. 16a n.1. The SEC later made clear to the court of appeals that, because it was "unlikely to receive any further relief by pursuing its excessive trading claims, the Commission has no intention of taking any further action against Zandford. Consequently, the Commission did not question the district court's decision to enter final judgment even though the Commission moved for partial summary judgment." Opp. App. 9a n.2.

Rather, both the Securities Act and the Exchange Act require that the defendant's fraud be connected to a securities transaction." Pet. App. 6a. The court noted that "[t]he precise contours of the in connection with requirement are not self-evident. . . . While the in connection with requirement must be flexible, it is not so elastic as to cover incidents which bear no relationship to market integrity or investor understanding." Pet. App. 7a.

Within this context, the court of appeals held that the federal securities laws do not extend to Zandford's fraudulent activities and that the "only connection with federal securities laws is that the funds were converted from a securities investment account." Pet. App. 14a (internal quotation marks and citation omitted); Pet. App. 7a-8a. The court held that the SEC had not alleged that "Zandford's inducements influenced any investment decision by the Woods other than to initially open their brokerage account." Pet. App. 9a. Dismissing the SEC's arguments concerning misappropriation and the applicability of *United States v. O'Hagan*, 521 U.S. 642 (1997), the court of appeals held that the only issue was "whether Zandford engaged in manipulation of a particular security," and held that he had not. Pet. App. 12a. Though it recognized that the conduct in question was "reprehensible," the court of appeals noted that Zandford "was criminally convicted and he doubtless faces other forms of civil liability and professional sanctions." Pet. App. 13a.

The court then concluded that, "while Zandford breached a fiduciary duty to the Woods, the Supreme Court has emphasized that the federal securities laws are not an open-ended breach of fiduciary duty ban." Pet. App. 14a. Accordingly, the court of appeals concluded that the SEC was not entitled to summary judgment and also directed that the case be dismissed. Pet. App. 14a.

SUMMARY OF ARGUMENT

The SEC urges this Court to conclude that § 10(b) and Rule 10b-5 are violated whenever a broker converts proceeds from the sales of securities in a client's account. However, § 10(b) prohibits only those types of fraud shown to be "in connection with the purchase or sale of any security." The court of appeals conducted the case-by-case analysis required by the language of § 10(b) and correctly held that neither Zandford's fraudulent scheme nor the conversion of the proceeds of securities sales established that the fraud was in connection with a sale of securities.

The plain language of § 10(b) limits the provision's application to manipulative or deceptive devices used "in connection with" a securities transaction. However, "manipulation or deception in connection with a securities transaction" means something different from "a securities transaction in connection with manipulation or deception." By excluding "a broader field involving any type of common law fraud in which a security was involved," this language "serves a useful filtration function." 8 Louis Loss & Joel Seligman, *Securities Regulation* 3686 (3d ed. 1991). The SEC urges this Court largely to eliminate that function by construing the phrase to encompass *any* nexus between deceptive devices and securities transactions.

Congress provided for a limited departure from its scheme of industry self-regulation by creating a catch-all for the use, by any person, of new manipulative and deceptive devices that corrupt the integrity of the market or influence investor understanding. Section 10(b) should be interpreted flexibly only to achieve those purposes.

Consistent with the limited purposes of § 10(b), the court of appeals properly held that evidence of conversion of funds from a securities investment account does not by itself establish a violation of § 10(b). The court concluded that the fraud was not shown to be in connection with a securities transaction because the fraud did not undermine market integrity or affect investor understanding. This conclusion is

consistent with the tests used by the Second and Seventh Circuits.

The SEC contends that the result reached by the court of appeals cannot be squared with *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). *Bankers Life*, however, does not support the SEC's contention that a fiduciary's misappropriation of the proceeds of securities sales necessarily violates § 10(b). As the court of appeals recognized, in *Bankers Life*, the defendant made misrepresentations about a particular security that induced another party either to "purchase or sell [a] security," Pet. App. 13a, and the seller was "duped into believing that it . . . would receive the proceeds" of the sale. *Bankers Life*, 404 U.S. at 9. In contrast, the Woods made no investment decision relating to any specific security. Moreover, the SEC's any nexus test is not supported by this Court's use of the word "touching" to describe the "in connection with" requirement. As Judge Friendly's careful analysis of that language in *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984), makes clear, the "touching" language restates, but does not articulate a test for interpreting, the "in connection with" requirement of § 10(b).

Alternatively, the SEC attempts to connect Zandford's deception directly to the securities sales. The SEC relies on this Court's decision in *O'Hagan* for the proposition that a sale of a security by a fiduciary who is feigning loyalty at the time of the sale violates § 10(b). However, *O'Hagan*, which addressed the use of misappropriated information in an insider trading case, does not support the SEC's use of fiduciary principles here. Although this Court announced no general "in connection with" test in *O'Hagan*, several factors influenced its decision that O'Hagan's deception was in connection with a securities transaction: (1) O'Hagan's fraud was consummated by a securities transaction; (2) misappropriated information can ordinarily be capitalized on only through a securities transaction; and (3) O'Hagan

simultaneously violated his fiduciary duty and harmed members of the investing public. This Court was also concerned about the consequences of not finding O'Hagan liable under § 10(b) because insider trading implicates the core congressional purposes behind the Act. None of these factors or concerns is present here.

First, the SEC has not proved that Zandford's sales were wrongful. Zandford was authorized, by virtue of the discretionary nature of the account, to engage in securities transactions without specific authorization for each transaction. That Zandford was feigning loyalty at the time of the sales does not, without more, establish a § 10(b) violation. Second, while O'Hagan could profit from the misappropriated information only through a securities transaction, the court of appeals correctly recognized that, because Zandford had control of the Woods' money before any securities transactions took place, the securities sales were not an essential part of his scheme. Third, Zandford's fraud did not harm the investing public in the same way as O'Hagan's. Zandford's conduct, though fraudulent, is not the type of deception that Congress perceived as a threat to market integrity, nor does it affect investor confidence in anything other than a particular broker or brokerage house. Further, holding that there is no § 10(b) violation in this case will not create a regulatory gap. Zandford's fraud is covered by other laws and regulations. In contrast, O'Hagan's trading on nonpublic information is the type of activity that led to federal regulation of the investment markets.

Finally, the SEC contends that its interpretation that § 10(b) and Rule 10b-5 apply to broker conversions merits deference. Pet. Br. 34–35. Although the SEC has been expressly delegated rulemaking authority under § 10(b), its interpretation of the "in connection with" requirement is not entitled to deference. Indeed, although *O'Hagan* raised questions about the proper application of the "in connection with" requirement of § 10(b), the government did not

request, and this Court did not grant, *Chevron* deference to the SEC's interpretation of that language.

Moreover, even if this Court is willing to defer to the SEC on this point, there is no SEC adjudication applying § 10(b) that is worthy of deference. The SEC primarily relies on a series of its public announcements and this Court's holding in *United States v. Mead Corp.*, 533 U.S. 218, 121 S. Ct. 2164 (2001), that agency adjudications can be worthy of *Chevron* deference. However, the SEC materials are not analogous to the agency adjudications referred to in *Mead*, 121 S. Ct. at 2173 n.12, which are much like published court opinions. The *Mead* adjudications contain extensive legal analysis, including examination of the underlying statutory language and the elements of the statutory provision. The materials offered by the SEC here, which consist merely of factual summaries and conclusory claims that § 10(b) applies, simply do not deserve deference. Finally, even if *Chevron* analysis were appropriate here, the SEC's proposed interpretation, that § 10(b) is violated any time a broker misappropriates a client's funds or securities, should be rejected because it is an unreasonable interpretation of § 10(b).

ARGUMENT

I. SECTION 10(b) ADDRESSES SPECIFIC FORMS OF MARKET MANIPULATION AND DECEPTION BY ANY PERSON AND IS NOT A CATCH-ALL PROVISION FOR ALL INSTANCES OF BROKER MISCONDUCT

The SEC argues that all broker conversions of client funds or securities violate § 10(b). Pet. Br. 8. Underlying that interpretation is the assumption that, because Congress intended for the *Act* to provide for comprehensive regulation of the securities industry, Pet. Br. 26, Congress intended *§ 10(b)* to provide that comprehensive regulation. Pet. Br. 24-28 (referring interchangeably to the purposes of

the Act and the purposes of § 10(b)). Interpreting that single provision independently to effectuate all of the remedial purposes of Congress's complex and extensive scheme for regulation of the securities industry cannot withstand analysis for three reasons.[4]

First, both the language of § 10(b) and its relation to other provisions of the securities laws accord greater significance to § 10(b)'s "in connection with" requirement than the SEC would allow. Second, though Congress found it "necessary to *provide for* regulation" of all aspects of securities transactions, Pet. Br. 26 (emphasis added), the structure and legislative history of the Act establish that Congress intended to provide for regulation through industry self-regulation with SEC oversight. *See Silver v. New York Stock Exchange*, 373 U.S. 341, 352-53 (1963) (observing that "[t]he pattern of governmental entry [into securities regulation] was by no means one of total displacement of the exchanges' traditional process of self-regulation"). Congress intended § 10(b) to serve an important, but limited, purpose as a catch-all for manipulative and deceptive devices that corrupt specific sales or purchases. Third, the SEC's legitimate concern that stockbroker conversion of client assets "is a serious and all-too-frequent form of fraud" that should not escape regulation, Pet. Br. 25, does not support the conclusion that § 10(b) always covers this type of conduct. Stockbroker conversion of client funds or securities is already covered by numerous provisions of the securities laws, exchange and

[4] This "Court has also noted that generalized references to the remedial purposes of the securities laws will not justify reading a provision more broadly than its language and the statutory scheme reasonably permit." *Aaron v. SEC*, 446 U.S. 680, 695 (1980) (internal quotation marks omitted) (quoting *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979)).

NASD regulations, state civil and criminal laws, and federal criminal law.[5]

A. The Language Congress Used in § 10(b) Confirms that the Provision Serves an Important, but Limited, Purpose in the Regulation of Securities Fraud

In construing § 10(b) and Rule 10b-5, implementing § 10(b), this Court has "turn[ed] first to the language of § 10(b), for 'the starting point in every case involving construction of a statute is the language itself.'" *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)). In the language of § 10(b), the phrase "in connection with" specifies the manner in which a manipulative or deceptive practice must relate to a purchase or sale of any security in order to violate the provision or any rules adopted thereunder. Whether considered independently or in comparison with other statutory provisions, § 10(b)'s "in connection with" requirement cannot be read to reach conduct that is no more than broker conversion of client funds or securities.

1. *"In Connection With" Specifies a Close Relationship Requiring that a Fraud Pertain to a Securities Transaction, Not Vice Versa*

The SEC interprets the language of § 10(b) to require "only that there be a nexus or relationship between the fraud and a securities transaction" such that any broker conversion of client assets violates § 10(b). Pet. Br. 19. By its language, however, § 10(b) does not reach all manipulative or deceptive practices that involve a securities transaction.

[5] Indeed, the same conduct that forms the basis of this proceeding under § 10(b) has already led to Zandford's federal wire fraud conviction, for which he was sentenced to more than four years in prison and ordered to pay restitution. Pet. App. 2a.

Cf. TRW Inc. v. Andrews, 122 S. Ct. 441, 449 (2001) ("[A] statute ought . . . to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." (internal quotation marks and citations omitted)). The range of meanings of the phrase "in connection with" is limited to denoting a close link, designation of which is usually made by a simple preposition such as "in," "on," or "pertains to." *See* Bergen Evans & Cornelia Evans, *A Dictionary of Contemporary American Usage* 386-88 (1957). As a compound-prepositional periphrasis, *see* H.W. Fowler, *A Dictionary of Modern English Usage* 105 (2d ed. 1965), "in connection with" modifies the object that it precedes. Evans & Evans, *supra*, at 386-88. In § 10(b), "in connection with" precedes, and therefore modifies, "the purchase or sale of any security."

Thus, the rules of usage support the intuitive conclusion that "manipulation or deception in connection with a securities transaction" means something different from "a securities transaction in connection with manipulation or deception." *Cf.* Loss & Seligman, *supra*, at 3686 ("By limiting Rule 10b-5 claims to instances when fraud occurred in connection with a security purchase or sale, rather than a broader field involving any type of common law fraud in which a security was involved, the ["in connection with"] element serves a useful filtration function."). In adopting the former formulation, Congress required that a manipulative or deceptive practice be a part of a securities transaction—that the manipulation or deception be in or pertaining to the transaction. The statute focuses on deceptions that affect securities transactions, and not on every scheme in which securities transactions play an incidental part.

2. *Considered in Comparison with Other Statutory Provisions, § 10(b)'s Language Does Not Cover All Instances of Broker Conversion*

The need for a direct link between a fraud and a purchase or sale of securities is evident from a comparison of § 10(b) and its "in connection with" language to other provisions of the Act. Section 15(b), for example—unlike § 10(b)—deals specifically with brokers. In specifying grounds for revoking or suspending a broker's registration, § 15(b) distinguishes between a crime that "involves the *purchase or sale of any security*," § 15(b)(4)(B)(i) (emphasis added), and a crime that "involves the larceny, theft, . . . embezzlement, *fraudulent conversion*, or misappropriation of funds, or securities." § 15(b)(4)(B)(iii) (emphasis added); *see* Act of Aug. 20, 1964, Pub. L. No. 88-467, 78 Stat. 571, § 6(b) (amending § 15 to add four categories of felonies or misdemeanors for conviction of which the SEC may deny registration). Juxtaposition of these two subsections of § 15(b)(4)(B) indicates that Congress recognized that fraudulent conversion or misappropriation of securities is a different species of misconduct from fraud that involves the purchase or sale of securities.[6]

Furthermore, Congress has demonstrated its capability to explicitly give an agency the power to deal with all forms

---

[6] A similar distinction can be found in the rules of the NASD. NASD Conduct Rule 2120 provides, in language similar to that of § 10(b), that "[n]o member shall effect any transaction in, or induce the purchase or sale of any security by means of any manipulative, deceptive or other fraudulent device or contrivance." National Association of Securities Dealers, Inc., NASD Manual (CCH) 4141 (2001). The rules address broker misuse of customer funds or securities in a separate provision devoted to fair dealing with customers, NASD Conduct Rule 2310-2(4)(A)(iv), NASD Manual, *supra*, at 4262, suggesting a recognition of the distinction between broker misconduct generally and transactional fraud in particular.

of broker fraud. It need not resort to the roundabout technique of deeming all broker fraud to be "in connection with" a securities transaction. Section 206 of the Investment Advisors Act of 1940 gives the SEC jurisdiction over fraud *by an investment advisor* against a client. Section 4o(1) of the Commodities Exchange Act (CEA) gives the Commodity Futures Trading Commission (CFTC) jurisdiction over fraud *by a commodities advisor* against a client, whereas § 4b(a) of the same statute gives the CFTC jurisdiction over fraud *in connection with* a commodities transaction. Transaction-oriented statutes like § 10(b) and CEA § 4b(a) differ from status-oriented statutes like CEA § 4o(1) and Investment Advisors Act § 206. The interpretation of the former statutes should not be distorted to focus on the defendant's status as a broker. *Cf. Moss v. Morgan Stanley Inc.*, 719 F.2d 5, 15 (2d Cir. 1983) ("We find nothing in the language or legislative history of section 10(b) or rule 10b-5 to suggest that Congress intended to impose a *special duty of disclosure* on broker-dealers simply by virtue of their status as market professionals."), *cert. denied*, 465 U.S. 1025 (1984).

B. The Act Codifies Congress's Plan for Self-Regulation Combined with Government Oversight, in Which § 10(b) Plays a Limited Role

Section 10(b) is not a tool by which the SEC can seek to effectuate all of the broad purposes of the Act.[7] Congress

[7] Imputing all of the Act's purposes to § 10(b), the SEC suggests that, because Congress stated its intention to provide a system for "settlement of securities transactions and the *safeguarding of securities and the funds related thereto*," Congress intended § 10(b) to safeguard securities and related funds. Pet. Br. 26 (quoting § 2). Congress did create a system for safeguarding securities and related funds, but it did so through an array of provisions other than § 10(b). *See, e.g.*, § 7 (providing for regulation of margin and other extensions of credit for the purchase of securities); § 8(b) (prohibiting brokers from lending a customer's securities without the customer's written consent).

did not enact a statute providing direct governmental regulation of *all* aspects of the securities trading process. Rather, it opted primarily for a model of self-regulation with SEC oversight. At the same time, it recognized the need for direct government regulation of manipulative or deceptive practices that fundamentally impair market operations. *See* S. Rep. No. 73-1455, at 30 (1934) (*hereinafter* Fletcher Report), *reprinted in* 2 Fed. Bar Ass'n Sec. Law Comm., Fed. Sec. Laws Legislative History 1933-1982, at 1293 (1983).

The SEC overlooks an important congressional motive when it declares that "[a]s the comprehensiveness of the Act makes clear, Congress intended to protect investors by regulating the *entire* securities trading process." Pet. Br. 26. The structure of the Act demonstrates Congress's general preference for self-regulation of the securities industry, subject to SEC oversight. *See* S. Rep. No. 73-792, at 1-5, (1934), *reprinted in* 2 Fed. Bar Ass'n Sec. Law Comm., *supra*, at 708, 708-12. By situating the primary responsibility for devising and enforcing regulations for broker conduct in the exchanges and over-the-counter securities associations,[8] the overall statutory scheme makes clear that Congress intended to protect investors by requiring the *industry* to regulate the *entire* securities trading process. Recognizing Congress's intent, this Court, in *Silver*, detailed the securities laws' approach to industry regulation:

> Thus arose the federally mandated duty of self-policing by exchanges. Instead of giving the Commission the power to curb specific instances of abuse, the Act placed in the exchanges a duty to register with the Commission, § 5, and decreed that

[8] Congress vested self-regulatory authority in over-the-counter securities associations with the Maloney Act of 1938, Pub. L. No. 719, 52 Stat. 1070 (1938).

> registration could not be granted unless the exchange submitted copies of its rules, § 6(a)(3), and unless such rules were "just and adequate to insure fair dealing and to protect investors," § 6(d).

373 U.S. at 352 (citations omitted).

Congress did not provide for direct governmental regulation of all aspects of the securities industry. Instead, Congress provided for comprehensive regulation by self-regulatory organizations (SROs), such as the New York Stock Exchange or the NASD,[9] with SEC oversight.[10] *See* S. Rep. No. 73-792, *supra*, at 13, at 720 (stressing that "the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves").

Since the adoption of the Act, Congress has expanded the SEC's authority over the SROs, but not by amending § 10(b), which has remained unchanged since its adoption in

---

[9] Indeed, the NASD confirms that "it is undoubtedly true that NASD Regulation would have authority to bring disciplinary proceedings against Respondent for misappropriating his client's assets." NASD Br. 15. It contends, however, that its powers to "punish violations of NASD rules and the federal securities laws were designed to *complement* the Commission's enforcement authority, not to *substitute* for it." NASD Br. 15. The structure and purpose of the Act, however, demonstrate that the SEC's powers under the Act were designed to complement the SROs' enforcement authority, not the other way around. To the extent that the NASD, or any other SRO, finds its procedures inadequate to enforce its rules, it can amend those procedures, NASD Br. 17-18 n.9 (discussing proposed amendment to NASD rules to enhance NASD Regulation authority), and the SEC can bring an action to enforce those rules, § 21(d).

[10] The language of § 2, to which the SEC directs this Court's attention, confirms that Congress found it "necessary to *provide for* regulation" of all aspects of the securities industry. Pet. Br. 26 (emphasis added).

1934.[11] When Congress amended the Act in 1975 to give the SEC "plenary power over self-regulatory rules," S. Rep. No. 94-75, at 131 (1975), *reprinted in* 3 Fed. Bar Ass'n Sec. Law Comm., *supra*, at 2805, it did so by amending §§ 19(c) and 21(d) and (f). Under the amendments to § 21(d) and (f), the SEC can now bring an action for a violation of an SRO's rules if either the SRO is unable or unwilling to act, or the action is in the public interest or for the protection of investors. The Act provides, and Congress has enhanced, the means by which the SEC can fill gaps in self-regulation of the brokerage industry, but it does not do so through § 10(b). It would be anomalous to assume that Congress intended to give primary regulatory authority to exchanges, and to craft a well-defined role for the SEC in overseeing that authority, only to dispense with its entire design by empowering the SEC to regulate all fraudulent conduct by industry professionals directly through § 10(b).

Congress intended § 10(b) to serve as a "catch-all." *See Ernst & Ernst*, 425 U.S. at 201-03 (quoting *Hearings on H.R. 7852 and H.R. 8720 before the House Committee on Interstate and Foreign Commerce*, 73d Cong. 115 (1934)); *see also Chiarella v. United States*, 445 U.S. 222, 226 (1980) ("Section 10(b) was designed as a catch-all clause to prevent fraudulent practices."). This Court has also noted, however, "that § 10(b) is not an all-purpose breach of fiduciary duty ban," *O'Hagan*, 521 U.S. at 655 (discussing *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977)), nor is it part of "a broad federal remedy

---

[11] Congress has, in fact, consistently resisted SEC requests to expand § 10(b). For example, when, in 1957 and 1959, the SEC "sought from Congress amendment of § 10(b) to change its wording . . . to 'in connection with the purchase or sale of, or any attempt to purchase or sell, any security,'" Congress refused to extend § 10(b)'s reach. *Blue Chip Stamps*, 421 U.S. at 732. Though Congress refused to amend § 10(b) to cover attempted violations, it did amend the catch-all anti-fraud provision applicable to brokers in over-the-counter transactions, § 15(c)(1), to apply to attempts.

for all fraud." *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982).

The description of § 10(b) as a "catch-all" means only that Congress intended the provision to extend the Commission's authority to new manipulative or deceptive devices—to "any *other* cunning devices," *id.* (emphasis added)—of the sort that Congress had chosen to include in § 9. *See* Edmund W. Kitch, *A Federal Vision of the Securities Laws*, 70 Va. L. Rev. 857, 859-60 (1984) (observing that § 10(b) is "designed to give the [SEC] the power to fill the inevitable omissions in the listing of manipulative devices in section 9"). "The extensive hearings that preceded passage of the 1934 Act touched only briefly on § 10, and most of the discussion was devoted to the enumerated devices that the Commission is empowered to proscribe under § 10(a)." *Ernst & Ernst*, 425 U.S. at 202. However, a spokesman for the drafters of § 9(c) of H.R. 7852, which would become § 10(b), described the purpose of the clause, explaining that "Subsection (c) says 'Thou shalt not devise any other cunning devices.'" *Hearings on H.R. 7852 and H.R. 8720*, *supra*, at 115 (1934) (testimony of Thomas G. Corcoran, spokesman for drafters). Corcoran described § 10(b) as "a catch-all clause to prevent manipulative devices . . . I do not think there is any objection to that kind of clause. The Commission should have the authority to deal with new manipulative devices." *Id.*

The Senate Report also discusses the types of new manipulative or deceptive practices—those that "might in some cases serve legitimate purposes"—that Congress intended the Commission to proscribe for the protection of investors or in the public interest and uses the examples of stabilization of security prices and grants of options. *See Ernst & Ernst*, 425 U.S. at 204-06; *see also* § 9(a)(6) (proscribing trades for the purpose of price stabilization in contravention of SEC rules). These practices directly implicate the concerns about manipulation corrupting the market that led Congress to make limited exceptions to its

self-regulation model when enacting §§ 9 and 10. *See* John E. Tracy & Alfred Brunson MacChesney, *The Securities Exchange Act of 1934*, 32 Mich. L. Rev. 1025, 1044 (1934). The Fletcher Report describes these concerns and the exchanges' inadequate response to these problems: "The true function of an exchange is to maintain an open market for securities, where supply and demand may freely meet at prices uninfluenced by manipulation and control. In the past this function has been fulfilled most imperfectly [by the exchanges]." Fletcher Report, *supra*, at 30.

Congress's use of different tools—self-regulation in some instances and direct proscription of defined practices in others—shows the flaw in the SEC's attempt to equate the purposes of § 10(b) with the broad purpose of pervasive securities industry regulation.[12] The court of appeals correctly applied a more discriminating approach and determined that § 10(b) was intended to protect market integrity and investor understanding. Pet. App. 7a. Brokers do play an important role in the securities industry, Pet. Br. 25, but given the focus of § 10(b) on the maintenance of market integrity in the face of new manipulative and deceptive devices, § 10(b) cannot be read to reach the entire

---

[12] In its amicus brief in support of the SEC, the AARP adopts the flawed premise that the reach of the securities laws is delimited by the reach of § 10(b). AARP Br. 18-21. While protecting "frequent targets of fraud," AARP Br. 2, is a legitimate concern, the AARP erroneously presumes that § 10(b) is the only source of that protection. That presumption misconstrues the regulatory scheme and ignores the extensive remedies available to victims of broker misappropriation of assets without resort to § 10(b). Indeed, because § 10(b) is limited to intentional wrongdoing, *see Aaron*, 446 U.S. at 691, it cannot serve as the basis for perhaps the most effective remedy, imposition of civil liability on a brokerage house under a theory of respondeat superior.

range of broker misconduct that Congress intended for the SROs to regulate under SEC supervision.[13]

C. Recognition that § 10(b) Does Not Reach All Instances of Broker Conversion Does Not Leave a Gap in the Regulation of Brokers

The SEC may be correct that "[t]here would be a significant gap in investor protection if stockbrokers could" misappropriate customer assets without *any* corrective oversight under the securities laws, Pet. Br. 25, but it does not follow that a gap exists because a broker can engage in this type of conduct without violating *§ 10(b)*. Congress has equipped the SEC with a number of tools to oversee the operation of the SROs and to ensure that broker misconduct does not escape regulation, without resort to § 10(b). *See, e.g.*, § 6(b)(5) (authorizing the SEC to deny registration to an exchange the rules of which are not designed to prevent fraud and manipulation); § 15A(b)(6) (authorizing the SEC to deny registration to a national securities association the rules of which are not designed to prevent fraud and manipulation); § 19(b) (requiring SEC approval of proposed changes to SRO rules); § 21(d) and (f) (authorizing the SEC to bring actions to enforce SRO rules when the SRO is unwilling or unable, or SEC action is necessary for the public interest or protection of investors). The SEC's recognition of

---

[13] Zandford's employer, Dominick & Dominick, is potentially subject to liability under other laws. Pet. App. 40a. Although that firm's liability was not raised here, Respondent did attempt to have the court of appeals take judicial notice of the fact that Diane Wood Okstulski filed a $2,620,000 lawsuit against Dominick & Dominick. *See Okstulski v. Dominick & Dominick*, 96-CV-604 (D. Md. filed Feb. 28, 1996). The SEC opposed the motion, and the court denied it on the same day that it announced its decision in the case. The point remains that victims of this type of fraud may seek redress from brokerage firms, regardless of whether the broker is liable under § 10(b).

this power—along with the other available remedies—dispels any concern that denying the SEC the authority to proceed under § 10(b) in this case would leave a gap in the regulation of brokers. Pet. Br. 28 n.9.

The type of conduct of which Zandford is accused would violate the rules of the NASD, *see* NASD Conduct Rule 2310, NASD Manual, *supra*, at 4261; NASD Br. 15, as well as the rules of every registered securities exchange. *See* § 6(b)(5) (requiring securities exchanges to have rules designed to prevent fraud and to maintain fair principles of trade). If the NASD is unwilling or unable to take appropriate action against Zandford for violation of its rules, the SEC has the authority to do so. *See* § 21(d). Similarly, if NASD enforcement of its rules fails to protect investors or serve the public interest, the SEC is authorized to enforce those rules directly, *see* § 21(f), or, if the rules themselves are inadequate, to prescribe new rules for the NASD, *see* § 19(c).

In the statutory scheme, SROs like the NASD represent the first line of defense against broker misconduct.[14] *See* S. Rep. No. 73-792, at 13 ("[T]he initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves."), *quoted in Silver*, 373 U.S. at 352. As the NASD notes in its brief supporting the SEC, "it is undoubtedly true that NASD Regulation would have authority to bring disciplinary proceedings against respondent for misappropriating his client's assets." NASD Br. 15. Indeed, in accordance with the Act's requirement that SROs promulgate and enforce rules "designed to prevent

---

[14] Ultimately, this type of fraud is best prevented by the SRO requirements that brokerage firms control the conduct of their employees. *See, e.g.*, NASD Rule 3010, NASD Manual, *supra*, at 4831-35. As the court of appeals noted in reviewing Zandford's wire fraud conviction, Zandford's conduct violated the rules of his employer, Dominick & Dominick. Pet. App. 37a.

fraudulent and manipulative practices, to promote just and equitable principles of trade," § 15A(b)(6); *accord* § 6(b)(5), the NASD holds brokers to exacting ethical standards.[15]

II. THE COURT OF APPEALS CORRECTLY HELD THAT CONVERSION OF THE PROCEEDS OF A SALE OF SECURITIES, WITHOUT MORE, DOES NOT VIOLATE § 10(b)

The court of appeals correctly concluded that "[t]he fact that Zandford's conduct as a broker may be within the scope of the securities statutes does not mean that his activities here necessarily constituted fraud in connection with a securities transaction." Pet. App. 14a. The court concluded that the fraudulent conversion of the proceeds of a sale of securities, without more in the record, does not constitute a violation of § 10(b). Pet. App. 14a. That conclusion is consistent with the interpretations of the "in connection with" requirement adopted by the Second and Seventh Circuits.

---

[15] The NASD is the only national securities association currently registered under the Maloney Act. *See* Loss & Seligman, *supra*, at 227. The reach of NASD regulation is extensive, even though NASD's "internal disciplinary remedies are applicable only to NASD member firms and persons associated with them." NASD Br. 16. That the NASD cannot enforce its rules against non-members is irrelevant to a claim of a gap in the regulation of broker misconduct. A securities broker who does not join the NASD must belong to an exchange, *see* § 15(b)(8) (requiring that any broker who effects transactions other than on an exchange of which he or she is a member must belong to a registered securities association, *i.e.*, the NASD), and thus be subject to a similar set of rules overseen by the SEC. *See* §§ 6, 15. Further, a broker who fails to register faces a number of serious consequences, including injunction, § 21(d); civil penalty, § 21A; and criminal prosecution resulting in a fine of up to $1,000,000 and imprisonment for up to ten years, § 32(a).

A. Conversion of the Proceeds of a Sale of Securities Is Not Deception "In Connection With" a Securities Transaction

The court of appeals held that the conversion of the proceeds of securities sales is not fraud in connection with the sales of securities because it "bear[s] no relationship to market integrity or investor understanding." Pet. App. 7a. The SEC did not allege that Zandford's inducements influenced any investment decision by the Woods other than the initial decision to open a brokerage account and to entrust Zandford with the authority to invest their money at his discretion. The SEC did not claim that Zandford had to obtain the Woods' approval before trading securities. Pet. App. 10a. Further, it produced no evidence that the sales of securities in question were "conducted in anything other than a routine and customary fashion." Pet. App. 9a. Finally, the SEC expressly disavowed before the court of appeals any argument that the establishment of the discretionary investment account could itself be considered a security as defined by the securities laws. Brief for the SEC, *SEC v. Zandford*, 238 F.3d 539 (4th Cir. 2001) (No. 99-1733) at 31 n.16 ("Zandford also discusses whether opening an account is an investment contract. The Commission has not relied on such a theory in this case.").

Having determined that the SEC had only established that "funds were converted from a securities investment account," the court of appeals correctly concluded that this evidence was insufficient to establish a violation of § 10(b). Pet. App. 14a. That outcome is consistent with the tests used by courts in the Second and Seventh Circuits to determine whether a fraud is in connection with a securities transaction. The Second Circuit's longstanding interpretation of the "in connection with" requirement dates back to its oft-cited decision in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). Building on that interpretation in *Chemical Bank*, Judge Friendly's opinion for the court addressed the question of

"whether misrepresentations or omissions involved in a securities transaction but not pertaining to the securities themselves can form the basis of a violation of § 17(a)"[16] of the Securities Act and § 10(b) of the Act. 726 F.2d at 943.[17] Judge Friendly answered that question in the negative, concluding that:

> The purpose of § 10(b) and Rule 10b-5 is to protect persons who are deceived in securities transactions—to make sure that buyers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the buyer to be inadequate or for a consideration known to the buyer not to be what it purports to be.

Id.

Applying *Chemical Bank*, courts in the Second Circuit have held that conversion of the proceeds of sales of securities is not a violation of § 10(b).[18] *See Pross*, 784 F.2d at

---

[16] Under § 17(a) of the Securities Act, the alleged fraud must be "in the offer or sale of any securities." Although "in the offer or sale" is arguably "narrower" than "in connection with the purchase or sale," this Court in *Bankers Life* "used the terms interchangeably." *United States v. Naftalin*, 441 U.S. 768, 773 n.4 (1979). At the petition stage, the SEC noted that it "d[id] not seek this Court's review . . . of the question whether the complaint [in this case] stated a claim under Section 17(a) because [the government had] not identified a square conflict between the decision of the court of appeals in this case and decisions of this Court or other courts of appeals on that question." Pet. Br. 4 n.1.

[17] In *Chemical Bank*, 726 F.2d at 943, Judge Friendly's opinion for the court answered the question this Court had left open with regard to § 17(a) of the Securities Act in *Rubin v. United States*, 449 U.S. 424, 429 n.6 (1981).

[18] The SEC contends that the *Chemical Bank* test has been modified by *SEC v. Drysdale Sec. Corp.*, 785 F.2d 38 (2d Cir.), *cert. denied*, 476

459 (Friendly, Oakes & Winter, JJ.) (holding that "conversion of property that happened to involve securities" did not violate § 10(b)); *see also Flickinger v. Harold C. Brown & Co.*, 947 F.2d 595, 598 (2d Cir. 1991) ("Section 10(b) is not violated by a fraudulent scheme that, some time after a purchase of securities, divests the purchaser of ownership."); *Bochicchio v. Smith Barney, Harris Upham & Co.*, 647 F. Supp. 1426, 1429-30 (S.D.N.Y. 1986) (holding that allegations that a broker with complete control over an account made unauthorized sales of securities and converted the proceeds did not state a § 10(b) claim). In the present case, the court of appeals applied the reasoning of the Second Circuit to conclude that the SEC had not alleged a § 10(b) violation. Pet. App. 7a-10a.

The result reached by the court of appeals is also consistent with decisions of the Seventh Circuit. That court generally holds that the "in connection with" requirement is satisfied only when allegedly fraudulent conduct

---

U.S. 1171 (1986), to "ma[k]e clear that the 'in connection with' requirement does not place a subject matter limitation on the misrepresentations that are actionable under Section 10(b)." Pet. Br. 42 n.15. The SEC misreads *Drysdale*. Judge Winter's opinion for the Second Circuit does not depart from—rather, it follows—*Chemical Bank*'s legal principles. The court in *Drysdale*, quoting the same passage from *Chemical Bank* quoted in the text of this brief above, noted that, under *Chemical Bank*, "fraud pertaining to the consideration in a securities transaction is in connection with that transaction." *Drysdale Sec. Corp.*, 785 F.2d at 42. It held that that test was met because the allegedly misrepresented fact "was essential to the value received by the other party in a securities transaction." *Id.* Exactly one week after releasing Judge Winter's opinion for the court in *Drysdale*, the Second Circuit released Judge Winter's opinion for the court—joined by Judge Friendly—in *Pross v. Katz*, 784 F.2d 455 (2d Cir. 1986), which, as discussed in text, also reaffirms *Chemical Bank* and pointedly shows its relevance to this case.

"influences an investment decision"—the decision whether to purchase or sell a security. *SEC v. Jakubowski*, 150 F.3d 675, 680 (7th Cir. 1998) (Easterbrook, J.), *cert. denied*, 525 U.S. 1103 (1999). The Seventh Circuit has also held that deceptive practices by an agent exercising discretionary authority do not give rise to liability under § 10(b).[19] In a discretionary account, the principal does not make any investment decisions, and while there may be a breach of a fiduciary duty, there is no violation of § 10(b). *See O'Brien v. Cont'l Illinois Nat'l Bank & Trust Co.*, 593 F.2d 54, 60 (7th Cir. 1979) (Tone, J.) ("Here, however, that decision was not whether [the defendant] should buy or sell the securities in question [on the plaintiffs' behalf] . . . The decision to which the nondisclosure related was whether plaintiffs should terminate the trust or agency agreements or, perhaps, take some action against [the defendant]."); *see also Congregation of the Passion, Holy Cross Province v. Kidder Peabody & Co.*, 800 F.2d 177, 181 (7th Cir. 1986) (authority retained by client "relat[ed] to its relationship with [its broker], not to any particular decision to purchase or sell a security. The federal protection of section 10(b) and Rule 10b-5 does not govern this relationship."). The Seventh Circuit's reasoning applies to this case because the Woods established a discretionary account and, thereafter, made no investment decisions regarding any purchases or sales of securities.[20]

---

[19] The SEC does not contest that Zandford had discretion to invest the Woods' assets. Pet. Br. 2.

[20] Congress has taken steps to protect owners of discretionary accounts under other provisions of the Act relating directly to brokers. *See, e.g.*, § 11(a)(1)(H) (requiring authorization from, and disclosures to, client for broker to exercise discretion); § 28(e)(2) (requiring brokers exercising investment discretion to make reports to the SEC according to SEC rules). In addition, several NASD Rules apply. *See* NASD Conduct Rule 2110, NASD Manual, *supra*, at 4112; NASD Conduct Rule IM-2310-2(b)(4)(A)(iv), NASD Manual, *supra*, at 4262; NASD Conduct Rule 2330(a), NASD Manual, *supra*, at 4291. Finally, state fiduciary and other common law rules apply. *O'Brien*, 593 F.2d at 60; Pet. App. 12a.

The SEC argues that this Court held in *Bankers Life* that "fraudulent misappropriation of the proceeds of a securities sale state[s] a cause of action under § 10(b)" and that *Bankers Life* therefore controls the outcome here. Pet. Br. 28.[21] *Bankers Life* does not stand for that proposition. In *Bankers Life*, the Second Circuit had held that, if the misrepresentation was not "[w]ith respect to the terms of the sale itself[,] neither the purchaser nor the seller of bonds was deceived or defrauded," and there was no violation of § 10(b). 430 F.2d 355, 360 (2d Cir. 1970). This Court disagreed and held that the seller was deceived because it "was duped into believing that it . . . would receive the proceeds" of the sale. 404 U.S. at 9.

What distinguishes *Bankers Life* from this case is that in *Bankers Life*, "the defendants made misrepresentations about a particular security that induced another party either to

---

[21] The SEC also cites a number of lower federal courts for the proposition that § 10(b) is implicated by the conversion of securities and the proceeds of securities sales. Pet. Br. 32-33 (citing *United States v. Kendrick*, 692 F.2d 1262 (9th Cir. 1982), *cert. denied*, 461 U.S. 914 (1983); *Mansbach v. Prescott, Ball, & Turben*, 598 F.2d 1017, 1027-29 (6th Cir. 1979); *Richardson v. MacArthur*, 451 F.2d 35, 39 (10th Cir. 1971)). Those cases, like the only case cited by the SEC in the court of appeals for the proposition that § 10(b) applies to conversion, lack any substantial "analysis to support [their] holding[s]." Pet. App. 11a. (citing *Henricksen v. Henricksen*, 486 F. Supp. 622, 629 (E.D. Wis. 1980)). The SEC also cites two cases from the Second and Seventh Circuits. Pet. Br. 33 (citing *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1094-95 (2d Cir. 1972); *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135, 144 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969)). Both of these cases predate the cases on which Respondent relies, and neither purports to depart from the tests developed in those circuits.

purchase or sell [a] security.". Pet. App. 13a.[22] As the SEC itself notes, the seller "needed to authorize the sale in *Bankers Life*" and was deceived into doing so. Pet. Br. 30. In contrast, the Woods were induced to part with money, *not* to purchase or sell any securities.[23] Zandford could buy or sell securities for the Woods' account without obtaining specific authorization for each transaction. Pet. Br. 30. He may have defrauded the Woods by taking their money in the first place, or by converting it later, but not by making the purchases and sales he was fully authorized to make.

The SEC correctly observes that this Court's opinion in *Bankers Life* did not rely on the fact that the defendants made an affirmative misrepresentation rather than omitting a material fact in the face of a duty to disclose. Pet. Br. 30

[22] The cases cited in *Bankers Life* do not support the proposition that a fraudulent misappropriation of securities necessarily violates § 10(b). *Contra* Pet. Br. 31 (citing 404 U.S. at 10 n.7 (citing *Allico Nat'l Corp. v. Amalgamated Meat Cutters*, 397 F.2d 727 (7th Cir. 1968); *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964))). As in *Bankers Life*, in each of these cases, the defrauded party was induced to purchase, pledge, or sell securities under the expectation that the defrauded party would receive something in return. *See Allico*, 397 F.2d at 730 (plaintiff induced to turn over 25,000 shares on expectation that union would fulfill contract); *Cooper*, 226 F. Supp. at 975 (plaintiff induced to pledge securities as collateral on expectation that shares would be returned upon repayment of loan). Because Zandford did not fraudulently induce the Woods to purchase, pledge, or sell securities, these cases are not relevant.

[23] The SEC cites to a recent article stating that the decision below "appears questionable." Lewis D. Lowenfels & Alan R. Bromberg, *Rule 10b-5's "In Connection With": A Nexus for Securities Fraud*, 57 Bus. Law. 1, 16 (2001). That opinion is apparently based in part on the premise that "[t]he broker obtained the client's securities by deception" and then sold the securities and stole the cash. *Id.* This premise, and the conclusion that follows, is faulty because Zandford did not obtain any securities by deception.

(arguing that Zandford's failure to disclose his disloyalty to his principals is the equivalent of the affirmative misrepresentation that was made in *Bankers Life*). Instead, this Court relied on the fact that "the seller was duped into believing that it, the seller, would receive the proceeds." *Bankers Life*, 404 U.S. at 9. Thus, the deception in *Bankers Life*, unlike Zandford's fraud, induced an investment decision.[24]

B. Contrary to the SEC's Claim, Showing Any Nexus Between a Deception and a Securities Transaction Does Not Satisfy the "In Connection With" Requirement of § 10(b)

The SEC asks this Court to conclude that the "in connection with" requirement is satisfied if there is *any* nexus between a fraud and a purchase or sale of securities. Pet Br. 19 (arguing that the language of § 10(b) requires "only that there be a nexus or relationship between the fraud and a securities transaction"). Under the SEC's test, because a sale of securities was incidentally involved in Zandford's scheme to convert the Woods' assets, his fraud would violate § 10(b). That test is not consistent with the language of § 10(b).

The SEC primarily relies on *Bankers Life* to support its proposed test. In *Bankers Life*, this Court concluded its opinion by stating that "[t]he crux of the present case is that

[24] For a similar reason, the SEC errs in asserting that the court of appeals's decision is in conflict with this Court's decisions in *Naftalin* and *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). Pet. Br. 40-41. As in *Bankers Life*, *Naftalin*'s fraud induced an investment decision, that of the broker to execute sell orders on the basis of representations by the client that he owned the stock. *Naftalin*, 441 U.S. at 770. In *Herman & MacLean*, this Court upheld § 10(b) liability when an investor's decision to purchase stock was made based on false information contained in a registration statement. 459 U.S. at 378, 382-83. Because the Woods made no similar investment decision, these decisions are inapposite.

[the seller] suffered an injury as a result of deceptive practices touching its sale of securities as an investor." 404 U.S. at 12-13. The SEC argues that, by using the word "touching" to describe the "in connection with" requirement, this Court in *Bankers Life* established that any nexus between a fraud and a securities transaction would suffice. Pet. Br. 19.

Subsequent interpretation makes clear that the SEC has read too much into the "touching" language. In *Chemical Bank*, 726 F.2d at 942-43, Judge Friendly, writing for the court, thoroughly analyzed the *Bankers Life* "touching" language, noting that other courts had initially decided that it articulated a new test but did not clearly identify its contours. *See, e.g., Mansbach*, 598 F.2d at 1027-28; *Brown v. Ivie*, 661 F.2d 62, 65 (5th Cir. 1981) (interpreting the "touching test" to require a nexus but not necessarily "'a direct or close relationship.'" (quoting *Alley v. Miramon*, 614 F.2d 1372, 1378 n.11 (5th Cir. 1980))), *cert. denied*, 455 U.S. 990 (1982). However, the court concluded that: (1) the language was likely a paraphrase rather than an explication of the "in connection with" requirement; (2) the language was dicta; and (3) courts interpreting the language to require only a tenuous connection generally applied it in situations "where the connection was anything but tenuous."[25] *Chem. Bank*, 726 F.2d at 942. The opinion cited to the conclusion of a leading commentator in this area, which stated that "there is no reason to believe that [Justice Douglas's] use of 'touching' was anything more than his variation of 'in connection with' as a matter of literary style." *Id.* (internal quotations

[25] Many of the cases cited by the SEC are examples of this interpretation of *Bankers Life*. Pet. Br. 19. *See, e.g., Abrams v. Oppenheimer Gov't Sec., Inc.*, 737 F.2d 582, 593 (7th Cir. 1984) (holding "in connection with" requirement 'easily satisfied' because defendants made fraudulent misrepresentations regarding value of securities at time of purchase and sale of security).

omitted) (quoting Louis Loss, *Fundamentals of Securities Regulation* 903-04 (1st ed. 1983)); *accord In re Ames Dept. Stores Inc. Stock Litig.*, 991 F.2d 953, 964 n.5 (2d Cir. 1993) (noting that "touch" test "seems chosen more to highlight the breadth the case advocated in interpreting the requirement than to provide a new test for the applicability of the Rule"); *In re Fin. Corp. of America Shareholder Litig.*, 796 F.2d 1126, 1130 (9th Cir. 1986) ("[t]he touch test . . . is nothing more than a restatement of the 'in connection with' test"). The "touching" language used in *Bankers Life* does not articulate a test with which to determine when a fraud is in connection with a purchase or sale of securities.

Moreover, this Court has not read *Bankers Life* to mandate an any nexus test. This Court has only once cited the "touching" language, and then only in passing. *Santa Fe*, 430 U.S. at 475-76 (noting that fraud must "touch" the purchase or sale of a security while rejecting the argument that claims of breaches of fiduciary duty, without deception, constitute § 10(b) violations). In *O'Hagan*, this Court interpreted the "in connection with" language without mentioning the "touching" language. 521 U.S. at 655-59. Similarly, last Term in *Wharf (Holdings) Ltd v. United Int'l Holdings, Inc.*, 532 U.S. 588, 121 S. Ct. 1776 (2001), this Court did not reach the question of whether a misrepresentation must "relat[e] to the value of a security purchase or the consideration paid" because the representation at issue did so relate. 121 S. Ct. at 1782 (internal quotation marks and citation omitted).

Without this Court's decision in *Bankers Life* to support its alternative any nexus test, the SEC is left only with its argument that the court of appeals's interpretation of the "in connection with" requirement engrafts a "limitation on the subject matter of the prohibited deception" that is inconsistent with the language of § 10(b). Pet. Br. 39. The court of appeals articulated the requisite connection between

the deception and the securities transaction in a way prescribed, not prohibited, by the language of the statute.[26]

In particular, the SEC argues that the court of appeals unreasonably narrowed the scope of § 10(b) by holding that the fraud must relate to "investment value" or to the "attributes of a particular security" to satisfy the "in connection with" requirement. Pet. Br. 39-42. The court of appeals did not impose those limitations on § 10(b). It explicitly acknowledged that "[t]he precise contours of the in connection with requirement are not self-evident." Pet. App. 7a. However, it did conclude that "it is not so elastic as to cover incidents which bear no relationship to market integrity or investor understanding."[27] Pet. App. 7a. The SEC cites cases in which this Court and other courts have

---

[26] The SEC's argument wrongly focuses attention on the deception requirement of § 10(b). The SEC is correct in asserting that the language of the statute does not limit the kinds of *deceptions* that may constitute violations of § 10(b). Pet. Br. 39. The language of the statute does limit its scope to deceptions *in connection with the purchase or sale of securities.*

[27] The court's use of the purposes of the statute to discern meaningful limitations is consistent with the approach taken by this Court in other contexts such as the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.* This Court has drawn parallels between the phrase "in connection with" and the phrase "relate to" that appears in ERISA. *See Egelhoff v. Egelhoff*, 532 U.S. 141, 121 S. Ct. 1322, 1327 (2001) (holding "that a state law relates to an ERISA plan 'if it has a connection with or reference to such a plan'" (quoting *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 97 (1983))). But this Court has noted that those phrases cannot be taken to extend "to the furthest stretch of [their] indeterminacy, . . . for really, universally, relations stop nowhere." *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 655 (1995) (internal quotation marks and citations omitted). Instead, this Court has "looked to the objectives of the . . . statute as a guide." *Id.* at 656.

found liability under § 10(b) although each "fraudulent scheme or device [was] unrelated to 'investment value.'" Pet. Br. 40. However, these examples, though not related to "investment value," are entirely consistent with the "market integrity or investor understanding" test that the court of appeals applied. Pet. App. 7a. Each case to which the SEC cites relates to the test used by the court of appeals because the fraud therein affects either market integrity[28] or investor understanding.[29] Pet. Br. 41-42. The court of appeals's interpretation of the "in connection with" requirement is thus consistent with the language of the statute.

The SEC has expressed concern that the decision below forecloses the application of § 10(b) to churning. Pet. Br. 19. Although this Court has never addressed the issue, churning is generally held to violate § 10(b). *See Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983) ("[C]hurning, in and of itself, may be a deceptive and manipulative device under section 10(b)."); *see also Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1367-68 (7th Cir. 1983); *Carras v. Burns*, 516 F.2d 251, 258 (4th Cir. 1975). The test used by the court of appeals would reach

---

[28] *See O'Hagan*, 521 U.S. at 653-54, 656 (insider trading); *Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615, 618 (9th Cir. 1981) (misrepresentation of risks of buying on margin).

[29] *See Naftalin*, 441 U.S. at 770-71 (misrepresentation of seller that he owned stock); *Bankers Life*, 404 U.S. at 9 (seller duped into believing it would receive proceeds); *Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 533 (2d Cir. 1999) (misrepresentation of date when funds from sale of security would be available); *Jakubowski*, 150 F.3d at 680-81 (misrepresentation of identity of purchaser); *Angelastro v. Prudential-Bache Sec., Inc.*, 764 F.2d 939, 941 (3d Cir.) (misrepresentations and nondisclosures regarding margin account interest rates), *cert. denied*, 474 U.S. 935 (1985); *Marbury Mgmt., Inc. v. Kohn*, 629 F.2d 705, 707 (2d Cir.) (misrepresentation of broker's qualifications), *cert. denied*, 449 U.S. 1011 (1980); *Fey v. Walston & Co., Inc.*, 493 F.2d 1036, 1040 (7th Cir. 1974) (recognizing that churning violates § 10(b)).

churning. *See* Loss & Seligman, *supra*, at 3874 ("Churning occurs when a securities broker engages in excessive trading in disregard of his customer's investment objectives for the purpose of generating commission business." (quoting *Mihara v. Dean Witter & Co.*, 619 F.2d 814, 820 (9th Cir. 1980))).

Finally, interpreting the "in connection with" language in the way proposed by the SEC would give § 10(b) a reach beyond that which Congress intended. The language of § 10(b) is otherwise inclusive, applying as it does to "any person" and to "any purchase or sale of a security." The "in connection with" requirement is the limiting language in the statute. By reading the "in connection with" language as satisfied by *any* nexus, the SEC essentially strips the statute of an important and intended limit on its reach. Under the SEC's proposed test, § 10(b) would apply to an employee who stole stock certificates from his or her employer and sold them. Allowing the statute to reach so far beyond securities fraud is inconsistent with the intent of Congress.

III. THE COURT OF APPEALS'S CONCLUSION THAT ZANDFORD'S SALES OF SECURITIES WERE AUTHORIZED AND DID NOT VIOLATE § 10(b) IS CONSISTENT WITH THIS COURT'S DECISION IN *O'HAGAN*

The SEC argues that Zandford's *sales of securities* violated § 10(b) even if the *conversion of the proceeds* did not. Pet. Br. 20. It is not difficult to see what drives the SEC to this counterintuitive theory. If the sales were themselves fraudulent, the SEC would have little trouble establishing the required connection between the fraud and the sales. However, that theory depends on the odd notion that Zandford would have committed actionable (and prosecutable) securities fraud if, at the time of fully authorized sales, he had intended to convert the proceeds but then changed his mind. No precedent supports that implausible result.

The SEC relies on this Court's decision in *O'Hagan* for the proposition that a sale of a security by a fiduciary violates § 10(b) if the fiduciary is feigning loyalty at the time the sale is made. Pet. Br. 20-21. It contends that Zandford violated § 10(b) when he sold the Woods' securities because he was feigning loyalty while acting on his own behalf. Pet. Br. 20. However, *O'Hagan* does not support the SEC's use of fiduciary principles.

In *O'Hagan*, a lawyer used material, nonpublic information regarding an impending tender offer made by a client of his firm to gain risk-free profits by purchasing the target's securities. *See* 521 U.S. at 647-48, 656. O'Hagan breached his fiduciary duty by purchasing the securities without disclosing to his principal that he was using confidential information. *Id.* at 656. Adopting the misappropriation theory,[30] this Court held that § 10(b) may be violated although the deceived party is not a participant in the securities transaction. *Id.*

Although this Court announced no general "in connection with" test, several factors influenced its decision that O'Hagan's deception was in connection with a securities transaction. *See id.*; *see also United States v. Falcone*, 257 F.3d 226, 233 (2d Cir. 2001) (recognizing that, in *O'Hagan*, this Court, while "not purport[ing] to set forth the sole combination of factors necessary to establish the requisite connection" between a deception and a securities transaction, did identify considerations relevant to

---

[30] The misappropriation theory complements traditional insider trading liability. *See O'Hagan*, 521 U.S. at 652. "In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." *Id.* *See generally* Barbara Bader Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101 (1984).

establishing that connection). This Court observed that: (1) O'Hagan's fraud was consummated "when, without disclosure to his principal, he use[d] the information to purchase or sell securities," so that "[t]he securities transaction and the breach of duty . . . coincide[d]"; (2) misappropriated insider information is "ordinarily capitalize[d] upon to gain no-risk profits through the purchase or sale of securities"; and (3) by trading on nonpublic information, O'Hagan at once violated his fiduciary duty and "harm[ed] members of the investing public." *O'Hagan*, 521 U.S. at 656.

This Court was also concerned with the consequences of not finding O'Hagan liable under § 10(b), noting that "investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law." *Id.* at 658. This Court observed that "it makes scant sense" that O'Hagan would be a § 10(b) violator "if he work[ed] for a law firm representing the target of a tender offer, but not if he work[ed] for a law firm representing the bidder." *Id.* at 659. Insider trading implicates the core congressional purposes behind the Act. *See id.* at 658 ("The [misappropriation] theory is . . . well tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence."). Construing *O'Hagan* outside of the insider trading context to encompass cases like the one here leads to the concern raised by the court of appeals: "[t]his would be tantamount to endorsing an all-purpose expansion of those [securities] statutes which would violate Congress' intent and subsume significant areas of state law." Pet. App. 14a. Expanding *O'Hagan* in this way would also frustrate Congress's allocation of primary responsibility for broker regulation to SROs.

Because none of the factors or concerns that led this Court to hold that O'Hagan's deception of his principal was in connection with his purchase of securities is present here, the SEC's claim that Zandford's sale of securities is more

closely connected to a deception than was the case in *O'Hagan*, Pet. Br. 20-21, does not withstand analysis.

A. The Sales of Securities Did Not Consummate Zandford's Fraud

The SEC stretches fiduciary principles to claim that the sales of securities—as opposed to their subsequent conversion—consummated a fraud. It first cites Charles H. Meyer, *The Law of Stockbrokers and Stock Exchange* (1931), for the proposition that "[r]espondent's sale of the Woods' securities for the undisclosed purpose of benefitting himself (by furthering his plan to misappropriate the proceeds) was a fraudulent conversion and embezzlement of the securities themselves." Pet. Br. 18 (citing Meyer, *supra*, § 136, at 552). Meyer, however, states that "[t]he *wrongful sale* of a customer's securities is a conversion of the securities." Meyer, *supra*, § 136 at 552 (emphasis added). The cases Meyer cites for support involve brokers who had *no* authority to make any purchases or sales in their clients' accounts without prior authorization; it was the lack of authority, not a mere intent to convert the proceeds later, that made the sales "wrongful." *See, e.g., Keller v. Halsey*, 202 N.Y. 588, 590-94, 597-98, 95 N.E. 634, 635-38 (1911) (holding that broker converted client's assets when he agreed to carry client's shares until the client directed them to be sold but sold the stocks without authority from the client or notice to him); *Mullen v. J.J. Quinlan & Co.*, 195 N.Y. 109, 115, 87 N.E. 1078, 1080 (1909) (holding that a sale of stock "without notice to, or the consent of," the owners constituted a conversion where "[t]here was no agreement permitting it and there was no default on their part justifying the act").[31]

---

[31] In addition to Meyer, the SEC also cites two state cases for this proposition. Pet. Br. 18 (citing *Taussig v. Hart*, 58 N.Y. 425 (1874); *Sherman v. State*, 124 Tex. Crim. 205, 208 (Tex. Crim. App. 1933)). In *Taussig*, the particular transaction was itself unauthorized. 58 N.Y. at 426-27 (agreement specified that stocks and gold should be

By contrast, there is no evidence that Zandford's sales of securities were wrongful. Zandford was authorized, by virtue of the discretionary nature of the Woods' account, to engage in securities transactions without specific authorization for each transaction. Pet. App. 10a. The SEC never established what securities were in the account or sold by Zandford, and, for purposes of summary judgment, it made no attempt to show that the stocks were themselves inappropriate for purchase or sale. Although there may have been a fraudulent scheme, it did not render all subsequent actions unauthorized. *See, e.g.*, Restatement (Second) of Contracts § 163 cmt. c. (1979); *Langley v. FDIC*, 484 U.S. 86, 94 (1987) (noting that fraud in the inducement rendered a promissory note "*voidable* but not void" (emphasis added)). In the absence of further evidence about the sales, given that the SEC exclusively relied on the wire-fraud-indictment facts for summary judgment purposes, the SEC has not established that the sales were deceptive.

Next, the SEC claims that the sales were a fraudulent conversion independent of the conversion of the proceeds because Zandford failed to disclose his feigned loyalty. Pet. Br. 20. For purposes of § 10(b), nondisclosure must refer to facts that are withheld by a fiduciary at the time of the sale, not wholly subjective intentions that are not integral to a securities transaction. *Cf. O'Hagan*, 521 U.S. at 655-56 (breach of duty occurred not when O'Hagan acquired the information but when he used it to purchase securities without disclosing that use to the principal).

---

purchased or sold "regular," but broker purchased them at "seller's option"). In *Sherman*, there was evidence that the authorization for the sale of particular stocks was induced by deception. 124 Tex. Crim. at 206, 61 S.W.2d 488, 489 (Tex. Crim. App. 1933) (client induced to transfer stock for sale by defendant based on defendant's fraudulent misrepresentations).

To allow the SEC to bootstrap Zandford's subjective intent into a § 10(b) violation without showing any effect on any securities transaction would undermine this Court's ruling in *Santa Fe* that limited the scope of § 10(b) to breaches of fiduciary duty that are independently manipulative or deceptive. 430 U.S. at 473-74. *Santa Fe* underscores that "§ 10(b) is not an all-purpose breach of fiduciary duty ban." *O'Hagan*, 521 U.S. at 655; *see also* Donald C. Langevoort, *Corporate Accountability: Seeking Sunlight in Santa Fe's Shadow*, 79 Wash. U. L.Q. 449, 456 (2001) ("[T]he subject of the alleged nondisclosure must be the underlying facts from which the possibility of a breach may be inferred. With citation to *Santa Fe*, courts consistently say that corporate managers are not expected to characterize their accusations in pejorative terms (self-accusations) or *volunteer information about their subjective motivations*." (emphasis added)).

After *Santa Fe*, as the Second Circuit noted in *Pross*, "generalized promises to act as a faithful fiduciary stand on a different footing than other promises of future performance. It is clear that a breach of a fiduciary duty by itself is not sufficient to make out a federal claim." 784 F.2d at 458 (citing *Santa Fe*); *see also Kas v. Fin. Gen. Bankshares, Inc.*, 796 F.2d 508, 513 (D.C. Cir. 1986) ("a plaintiff may not 'bootstrap' a claim of breach of fiduciary duty into a federal securities claim by alleging that directors failed to disclose that breach of fiduciary duty"); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 288 (7th Cir.) ("In the wake of *Santa Fe*, courts have consistently held that since a shareholder cannot recover under 10b-5 for a breach of fiduciary duty, neither can he 'bootstrap' such a claim into a federal securities action by alleging that the disclosure philosophy of the statute obligates defendants to reveal either the culpability of their activities, or their impure motives for entering the allegedly improper transaction."), *cert. denied*, 454 U.S. 1092 (1981). This is not to say that promissory fraud that induces an investment decision would not be actionable under

§ 10(b). *See Wharf (Holdings)*, 121 S. Ct. at 1781-82 (holding that Wharf's secret intent not to honor an option that it sold violated § 10(b) because, among other factors, its secret intent rendered the option valueless). However, a generalized promise that does not induce an investment decision cannot form the basis of a § 10(b) violation.

The SEC cannot establish a § 10(b) violation based entirely on what Zandford was thinking. Accepting the contrary premise would lead to the implausible result that any broker who at some point harbored impure thoughts regarding a securities transaction would be liable under § 10(b), even if he abandoned his intention and never consummated the fraud. *See Pross*, 784 F.2d at 459 ("An intent to cause a conversion of ownership interests at some uncertain future time and through uncertain means does not bring federal law into play, even though that intent is held at the time a purchase or sale of securities occurs."). *Pross* involved a two-year lapse between the securities transactions and the conversion. *See id.* at 656-57. Although there is no comparable delay here, the same deficiency exists. The SEC failed to prove that the securities transactions were unauthorized. Rather, it was the conversion of the proceeds, through three contractual arrangements, that was found to be fraudulent. Pet. App. 36a-37a. Zandford's deception related to these arrangements, not to the securities sales themselves.

The SEC's emphasis on Zandford's state of mind, followed to its logical conclusion, conflicts with this Court's reasoning in *O'Hagan*. If anything, Zandford embezzled the Woods' funds—not their stocks—because he allegedly harbored the subjective intent to convert the funds when he obtained control of them. As the court of appeals noted, based on *O'Hagan*, purchasing stocks with embezzled funds does not implicate § 10(b):

> [This] Court also noted, with apparent approval, the government's contention that § 10(b) would not apply to a case in which a person defrauded a bank into giving him a loan or embezzled cash from another, and then used the proceeds of the misdeeds to purchase securities. . . . The same logic applies to Zandford's fraudulent conduct.

Pet. App. 12a (citations omitted).

B. The Other Factors Underlying this Court's Holding in *O'Hagan* Are Not Present Here

In addition to the fact that O'Hagan's fraud was consummated by the securities transaction, this Court took two other factors into consideration in its analysis of the "in connection with" requirement. This Court declared it significant that insider information ordinarily had value only if used in a subsequent stock transaction. *O'Hagan*, 521 U.S. at 657. That factor was important to its analysis of the "in connection with" requirement because it made the securities transaction an essential part of O'Hagan's scheme. *See id.* at 656-57. That is not the case here. The court of appeals correctly recognized that, because Zandford had control of the money before any securities transactions took place, his "sales were incidental to his scheme to defraud." Pet. App. 9a. Indeed, in affirming Zandford's wire fraud conviction, the court of appeals addressed the sufficiency of the evidence to convict without mentioning any securities transactions. Pet. App. 36a-37a.

This Court also noted that the securities transactions in *O'Hagan* at once deceived the principal and harmed investors who sold securities due to an unfair informational disadvantage "vis-à-vis a misappropriator with material, nonpublic information." 521 U.S. at 658-59. By contrast, Zandford's sales were not shown to be harmful independent of the subsequent conversion of the proceeds, and they affected no investment decision. Pet. App. 13a ("Zandford's statements or omissions were not about a particular security. Nor did his omissions induce the Woods or anyone else to buy or sell a particular stock."). As the court of appeals correctly concluded, "[t]he misappropriated proceeds might

as well have come from the unlawful sale of a car which the Woods had entrusted to Zandford's care." Pet. App. 12a.

IV. THE SEC'S INTERPRETATION IS NOT ENTITLED TO *CHEVRON* DEFERENCE

The SEC contends that its "interpretation of Section 10(b) and Rule 10b-5 . . . must be given effect by the courts" under the doctrine of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984), Pet. Br. 38, and that it "has interpreted Section 10(b) and Rule 10b–5 to prohibit the fraudulent misappropriation by broker-dealers . . . of customer securities and the proceeds of securities sales." Pet. Br. 34–35. Both of these contentions are incorrect. First, this Court has never held that Congress gave the SEC the power to interpret the "in connection with" requirement of § 10(b) authoritatively, and the SEC has never previously requested that this Court defer to its interpretations of § 10(b). Second, the agency adjudications to which the SEC asks this Court to defer lack the rigorous analysis and interpretation of § 10(b) or Rule 10b-5 necessary to warrant *Chevron* deference. For these reasons, the SEC is not entitled to the deference it seeks.

A. Both this Court and the SEC Have Traditionally Understood that the SEC's Interpretation Is Not Entitled to *Chevron* Deference

The SEC's interpretation of § 10(b) is entitled to *Chevron* deference only if Congress intended to delegate to the agency the authority to speak with the force of law. *See Mead*, 121 S. Ct. at 2172 & n.11; *Chevron*, 467 U.S. at 865. Although the SEC enjoys some expressly delegated rulemaking authority under § 10(b), including the power to promulgate Rule 10b-5, the Act does not allow the agency to define the "in connection with" limitation. *See Adams Fruit Co. v. Barrett*, 494 U.S. 638, 650 (1990) (holding that express grant of authority to promulgate standards under statute did not empower agency to regulate the scope of judicial power

thereunder). The long-standing practice of this Court, as well as the SEC, strongly implies that the SEC lacks this authority.

Though eighteen years have passed since *Chevron* was decided, the SEC cites no case in which it has taken the position that Congress intended the courts to defer to its interpretation of § 10(b). During that period, this Court decided many § 10(b) cases, and the SEC filed more than a dozen party and amicus briefs without requesting *Chevron* deference.[32] Even when this Court found "the SEC's insights . . . helpful" and accorded them an unspecified level of "due deference," it reached its conclusion without invoking the *Chevron* doctrine. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.16 (1988). Indeed, the SEC's helpful insights were merely that it approved of the Second Circuit's interpretation of § 10(b) in *Texas Gulf Sulphur*. *See Basic Inc.*, 485 U.S. at 239 n.16.

This Court's (and the SEC's own) understanding of the limits of the SEC's entitlement to *Chevron* deference is well-illustrated in *O'Hagan* (and the SEC's brief in that case). Though *O'Hagan* raised questions about the proper application of the "in connection with" requirement of § 10(b), the government did not request, and this Court did not grant, *Chevron* deference to the SEC's interpretation of that language. The government's failure to request deference under § 10(b) is significant because, in the same case, it did ask for deference for the SEC's interpretation of

---

[32] This Court has reviewed § 10(b) without deferring to the SEC's interpretation. *See, e.g., Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 176-77 (1994) (rejecting the SEC's position regarding the coverage of aiding and abetting under Rule 10b-5); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 361-62 (1991) (rejecting the SEC's position regarding the length of a federal statute of limitations for Rule 10b-5 actions); *Aaron*, 446 U.S. 680, 701-02 (rejecting the SEC's position that injunctive enforcement under § 10(b) does not require scienter).

§ 14(e). Brief for the United States at 36, 41, *O'Hagan* (No. 96-842). This Court, while granting deference to the SEC's interpretation of § 14(e), also noted that § 10(b) was not subject to the same analysis. *O'Hagan*, 521 U.S. at 673. As this Court's opinion makes clear, the SEC's rulemaking authority under § 10(b) is more limited than under § 14(e). *See id.* at 651, 657.

This Court's failure to grant *Chevron* deference reflects an understanding long shared by the SEC and this Court that Congress intended for the judiciary to define the limits of § 10(b) without deferring to the SEC's interpretation. Rather, Congress granted the SEC rulemaking powers "to catalogue deceptive and manipulative devices and practices prohibited under Section 10(b)," Pet. Br. 37, but the courts determine the meaning of "in connection with the purchase or sale of a security." *See Ernst & Ernst*, 425 U.S. at 214 (holding that "despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)").

The broad reach of § 10(b) also suggests that Congress did not intend to grant deference to the SEC regarding the scope of § 10(b). The provision's expansive language reaches *any* purchase or sale and applies to *any* person acting under a broad range of circumstances. Section 10(b) gives rise to SEC and implied private rights of action, *see Bankers Life*, 404 U.S. at 13 n.9, and can also serve as the basis for a criminal prosecution. *See* § 32(a). Given the broad implications of § 10(b), and the variety of non-SEC initiated actions that the courts must adjudicate, deference to the SEC is particularly inappropriate. *Cf. Adams Fruit*, 494 U.S. at 649 (finding deference inappropriate when Congress has expressly established the judiciary as adjudicator of private rights of action).

For these reasons, it is implausible to conclude that Congress intended for the courts to defer to the SEC's interpretation of § 10(b). However, even if Congress in 1934

had intended to allow the SEC to set the limits of its own § 10(b) jurisdiction, the intervening sixty-eight years of non-deferential review have created settled case law to the contrary. *See Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 131 (1990) ("Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of stare decisis, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning.").

B. The Sources on Which the SEC Relies Do Not Constitute an Authoritative Agency Interpretation

To support its claim of an authoritative agency interpretation of § 10(b), the SEC relies on a series of its public announcements,[33] and this Court's holding that agency adjudications can be worthy of *Chevron* deference. Pet. Br. 37 (citing *Mead*, 121 S. Ct. at 2171). However, "[t]o say that *Chevron* governs a particular case is not to assume that it applies equally to all agency adjudications." *Bob Evans Farms v. NLRB*, 163 F.3d 1012, 1019 (7th Cir. 1998) (analyzing the proper deference given to agency adjudication and concluding that though the NLRB "can, and occasionally does, make rules in the course of adjudication, the bulk of its orders have only a slight legislative dimension"). The difference between the SEC's materials and the agency adjudications cited by this Court in *Mead* as deserving deference is telling.

---

[33] The SEC also cites two district court opinions, neither of which is relevant to the question of whether the SEC has articulated an authoritative interpretation of Rule 10b-5. Pet. Br. 35 & n.12. In *SEC v. Lawson*, 24 F. Supp. 360 (D. Md. 1938), § 10(b) was not raised; in fact, the case was decided four years before the enactment of Rule 10b-5. In *Cooper*, 226 F. Supp. at 978, the court merely noted that the SEC had frequently taken action against brokers who had defrauded clients out of funds.

The adjudications referenced in *Mead*, 121 S. Ct. at 2173 n.12, are much like published court opinions. They contain extensive legal analysis, including examination of the underlying statutory language and the elements of the provision. *See, e.g., ABF Freight Sys.*, 304 N.L.R.B. 585 (1991) (deferred to in *ABF Freight Sys., Inc. v. NLRB*, 510 U.S. 317, 324-325 (1994)); *Imco Poultry*, 202 N.L.R.B. 259 (1973) (deferred to in *Holly Farms Corp. v. NLRB*, 517 U.S. 392, 401-03 (1996)). In comparison, none of the SEC releases, Pet. Br. 35 & n.12, 36 & n.13, provides any analysis of the terms used in § 10(b) or states the rule for which the agency now seeks deference.[34] Rather, each of the releases merely recites factual circumstances and, without any analysis of the statutory requirements, summarily concludes that those circumstances constitute a violation of Rule 10b-5. *See, e.g., Southeastern Sec. Corp.*, Exchange Act Release No. 4,274 (1949) (consisting of extensive factual recapitulation followed by summary findings of Rule 10b-5 violations). Indeed, the case on which the SEC most heavily relies contains virtually no legal analysis. *See Kenneth Leo Bauer*, Exchange Act Release No. 4,006 (1947) (containing only a

[34] The SEC primarily relies on Exchange Act Releases, describing SEC agency adjudications, and Litigation Releases, describing court proceedings to which the SEC is party. Such releases have "less precedential and predictive value than do rules that are promulgated as a result of the more formal interpretive rule-making process." 1 Thomas Lee Hazen, *Law of Securities Regulation* 17 (3d ed. 1996); *see SEC v. Adler*, 137 F.3d 1325, 1339 (11th Cir. 1998) (declining to defer to SEC interpretation of § 10(b) contained in SEC report, congressional testimony, and litigation because, among other reasons, SEC material failed to provide legal analysis); *Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 257 n.3 (2d Cir. 1994) (noting SEC concession that some informal statements such as no-action letters or Commission comments thereon are not entitled to the *Chevron* deference afforded to formal policy statements or rulemaking orders).

one-sentence conclusion declaring defendant, who made no appearance at hearing, in violation of Rule 10b-5).

The SEC adjudications simply do not exhibit the "relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force." *Mead*, 121 S. Ct. at 2172 (explaining the indicia of congressional intent to confer law-making power upon an agency); *see also SEC v. Sloan*, 436 U.S. 103, 117-18 (1978) ("[S]ince this Court can only speculate as to the Commission's reasons for reaching the conclusion that it did, the mere issuance of consecutive summary suspension orders, without a concomitant exegesis of the statutory authority for doing so, obviously lacks 'power to persuade' as to the existence of such authority.") (citing *Adamo Wrecking Co. v. United States*, 434 U.S. 275, 287 n.5 (1978)). Nor do the arguments offered for the first time by the SEC in its brief close the analytical gap in the agency's jurisprudence because "courts may not accept appellate counsel's post hoc rationalizations" as substitutes for considered agency declarations.[35] *Bowen v. Georgetown Univ.*

[35] Giving *Chevron* deference to such announcements would also allow agencies to interpret statutes without appropriate analytical rigor and, thereby, defeat the Administrative Procedure Act's purpose of assuring due deliberation. *See Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 741 (1996). Both the now chairman of the SEC and a former commissioner have recognized that one of the "dangers inherent in the administrative process is that agencies will eschew formal rulemaking for *ad hoc* enforcement actions, using discrete enforcement proceedings as a vehicle for developing new legal standards as the need arises." Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 Yale J. on Reg. 149, 168 (1990); *accord* Roberta S. Karmel, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor*, 61 Law & Contemp. Prob. 33, 42 (1998).

Hosp., 488 U.S. 204, 212 (1988) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

Finally, even if *Chevron* analysis were appropriate here, it would not advance the SEC's case. The SEC's proposed interpretation, that § 10(b) is violated any time a broker misappropriates a client's funds or securities, could not survive *Chevron* scrutiny because it is an unreasonable interpretation "manifestly contrary" to the established law of § 10(b). 467 U.S. at 844. Courts have recognized that application of § 10(b)'s "in connection with" language can be difficult. *See, e.g., Chem. Bank*, 726 F.2d at 942; Loss & Seligman, *supra*, at 3680 & n.558. Accordingly, the courts have consistently determined the contours of § 10(b) through *de novo* case-by-case adjudication. *See, e.g., Central Bank*, 511 U.S. at 172-73 (collecting cases in which this Court has defined the contours of § 10(b)). Thus, it would be unreasonable for the SEC to adopt the *per se* standard it proposes here.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

ROY T. ENGLERT, JR.
Robbins, Russell, Englert, Orseck & Untereiner LLP
1801 K Street, N.W.
Suite 411
Washington, DC 20006
(202) 775-4503

STEVEN H. GOLDBLATT
Counsel of Record
ABIGAIL V. CARTER
WENDY M. MARANTZ
Appellate Litigation Program
Georgetown University Law Center
111 F Street, N.W.
Suite 123
Washington, DC 20001
(202) 662-9555

FEBRUARY 4, 2002

APPENDIX

§ 2, 15 U.S.C. § 78b. NECESSITY FOR REGULATION

For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

(1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of interstate commerce; (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted

throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.

§ 9, 15 U.S.C. § 78i. MANIPULATION OF SECURITY PRICES

(a) Transactions relating to purchase or sale of security

It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of

interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—

(1) For the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security, (A) to effect any transaction in such security which involves no change in the beneficial ownership thereof, or (B) to enter an order or orders for the purchase of such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties, or (C) to enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange or in connection with any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) with respect to such security creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

(3) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) with respect to such security, to induce the purchase or sale of any security registered on a national securities exchange or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) with respect to such security by the circulation or dissemination in the ordinary course of

business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any one or more persons conducted for the purpose of raising or depressing the price of such security.

(4) If a dealer or broker, or the person selling or offering for sale or purchasing or offering to purchase the security or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) with respect to such security, to make, regarding any security registered on a national securities exchange or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) with respect to such security, for the purpose of inducing the purchase or sale of such security or such security-based swap agreement, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

(5) For a consideration, received directly or indirectly from a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) with respect to such security, to induce the purchase of any security registered on a national securities exchange or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) with respect to such security by the circulation or dissemination of information to the effect that the price of any such security will or is likely to rise or fall because of the market operations of any one or more persons conducted for the purpose of raising or depressing the price of such security.

(6) To effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange for the purpose of pegging, fixing, or stabilizing the price of such security in contravention of such rules and

regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

§ 15, 15 U.S.C. § 78o. REGISTRATION AND REGULATION OF BROKERS AND DEALERS

(b) Manner of registration of brokers and dealers

* * * * *

(4) The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated –

* * * * *

(B) has been convicted within ten years preceding the filing of any application for registration or at any time thereafter of any felony or misdemeanor or of a substantially equivalent crime by a foreign court of competent jurisdiction which the Commission finds –

(i) involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, any substantially equivalent activity however denominated by the laws of the relevant foreign government, or conspiracy to commit any such offense;

(ii) arises out of the conduct of the business of a broker, dealer, municipal securities dealer, government securities broker, government securities dealer, investment adviser, bank, insurance company, fiduciary, transfer agent, foreign person performing a function substantially equivalent to any of the above, or entity or person required to be registered

under the Commodity Exchange Act (7 U.S.C. 1 et seq.) or any substantially equivalent foreign statute or regulation;

(iii) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or substantially equivalent activity however denominated by the laws of the relevant foreign government; or

(iv) involves the violation of section 152, 1341, 1342, or 1343 or chapter 25 or 47 of Title 18, or a violation of a substantially equivalent foreign statute.

* * * * *

(8) It shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than or [sic] commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to section 78o-3 of this title or effects transactions in securities solely on a national securities exchange of which it is a member.

* * * * *

(c) Use of manipulative or deceptive devices; contravention of rules and regulations

(1)(A) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member, or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), by means of any manipulative, deceptive, or other fraudulent device or contrivance.

* * * * *

(2)(A) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to

effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member, in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation.

* * * * *

(D) The Commission shall, for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious.

* * * * *

(3)(A) No broker or dealer (other than a government securities broker or government securities dealer, except a registered broker or dealer) shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security (except a government security) or commercial paper, bankers' acceptances, or commercial bills) in contravention of such rules and regulations as the Commission shall prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers including, but not limited to, the acceptance of custody and use of customers' securities and the carrying and use of customers' deposits or credit balances. Such rules and regulations shall (A) require the maintenance of reserves with respect to customers' deposits or credit balances, and (B) no later than September 1, 1975, establish minimum financial responsibility requirements for all brokers and dealers.

* * * * *

(4) If the Commission finds, after notice and opportunity for a hearing, that any person subject to the provisions of section 78l, 78m, 78n of this tile, or subsection (d) of this section or any rule or regulation thereunder has failed to comply with any such provision, rule, or regulation in any material respect, the Commission may publish its findings and issue an order requiring such person, and any person who was a cause of the failure to comply due to an act or omission the person knew or should have known would contribute to the failure to comply, to comply, or to take steps to effect compliance, with such provision or such rule or regulation thereunder upon such terms and conditions and within such time as the Commission may specify in such order.

(5) No dealer (other than a specialist registered on a national securities exchange) acting in the capacity of market maker or otherwise shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or a municipal security) in contravention of such specified and appropriate standards with respect to dealing as the Commission, by rule, shall prescribe as necessary or appropriate in the public interest and for the protection of investors, to maintain fair and orderly markets, or to remove impediments to and perfect the mechanism of a national market system. Under the rules of the Commission a dealer in a security may be prohibited from acting as a broker in that security.

(6) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security, municipal security, commercial paper, bankers' acceptances, or commercial bills) in contravention of such rules and regulations as the Commission shall prescribe as necessary or appropriate in the public interest and for the

protection of investors or to perfect or remove impediments to a national system for the prompt and accurate clearance and settlement of securities transactions, with respect to the time and method of, and the form and format of documents used in connection with, making settlements of and payments for transactions in securities, making transfers and deliveries of securities, and closing accounts. Nothing in this paragraph shall be construed (A) to affect the authority of the Board of Governors of the Federal Reserve System, pursuant to section 78g of this title, to prescribe rules and regulations for the purpose of preventing the excessive use of credit for the purchase or carrying of securities, or (B) to authorize the Commission to prescribe rules or regulations for such purpose.

* * * * *

§ 15A, 15 U.S.C. § 78o-3. REGISTERED SECURITIES ASSOCIATIONS

(b) Determinations by Commission requisite to registration of applicant as national securities association

An association of brokers and dealers shall not be registered as a national securities association unless the Commission determines that—

* * * * *

(6) The rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, to fix minimum

profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the association.

(7) The rules of the association provide that (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) its members and persons associated with its members shall be appropriately disciplined for violation of any provision of this chapter, the rules or regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or the rules of the association, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

* * * * *

§ 19, 15 U.S.C. § 78s. REGISTRATION, RESPONSIBILITIES, AND OVERSIGHT OF SELF-REGULATORY ORGANIZATIONS

(b) Proposed rule changes; notice; proceedings

(1) Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule

change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) Within thirty-five days of the date of publication of notice of the filing of a proposed rule change in accordance with paragraph (1) of this subsection, or within such longer period as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall—

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved. Such proceedings shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be concluded within one hundred eighty days of the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to sixty days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the self-regulatory organization consents.

The Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this chapter and the rules and regulations thereunder applicable to such organization. The Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the thirtieth day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(3)(A) Notwithstanding the provisions of paragraph (2) of this subsection, a proposed rule change may take effect upon filing with the Commission if designated by the self-regulatory organization as (i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization, (ii) establishing or changing a due, fee, or other charge imposed by the self-regulatory organization, or (iii) concerned solely with the administration of the self-regulatory organization or other matters which the Commission, by rule, consistent with the public interest and the purposes of this subsection, may specify as without the provisions of such paragraph (2).

(B) Notwithstanding any other provision of this subsection, a proposed rule change may be put into effect summarily if it appears to the Commission that such action is necessary for the protection of investors, the maintenance of fair and orderly markets, or the safeguarding of securities or funds. Any proposed rule change so put into effect shall be filed promptly thereafter in accordance with the provisions of paragraph (1) of this subsection.

(C) Any proposed rule change of a self-regulatory organization which has taken effect pursuant to subparagraph (A) or (B) of this paragraph may be enforced by such organization to the extent it is not inconsistent with the provisions of this chapter, the rules and regulations thereunder, and applicable Federal and State law. At any time within sixty days of the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1) of this subsection, the Commission summarily may abrogate the change in the rules of the self-regulatory organization made thereby and require that the proposed rule change be refiled in accordance with the provisions of paragraph (1) of this subsection and reviewed in accordance with the provisions of paragraph (2) of this subsection, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of

investors, or otherwise in furtherance of the purposes of this chapter. Commission action pursuant to the preceding sentence shall not affect the validity or force of the rule change during the period it was in effect and shall not be reviewable under section 78y of this title nor deemed to be "final agency action" for purposes of section 704 of Title 5.

* * * * *

(c) Amendment by Commission of rules of self-regulatory organizations

The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as "amend") the rules of a self-regulatory organization (other than a registered clearing agency) as the Commission deems necessary or appropriate to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this chapter, in the following manner:

(1) The Commission shall notify the self-regulatory organization and publish notice of the proposed rulemaking in the Federal Register. The notice shall include the text of the proposed amendment to the rules of the self-regulatory organization and a statement of the Commission's reasons, including any pertinent facts, for commencing such proposed rulemaking.

(2) The Commission shall give interested persons an opportunity for the oral presentation of data, views, and arguments, in addition to an opportunity to make written submissions. A transcript shall be kept of any oral presentation.

(3) A rule adopted pursuant to this subsection shall incorporate the text of the amendment to the rules of the self-regulatory organization and a statement of the Commission's basis for and purpose in so amending such rules. This statement shall include an identification of any

facts on which the Commission considers its determination so to amend the rules of the self-regulatory agency to be based, including the reasons for the Commission's conclusions as to any of such facts which were disputed in the rulemaking.

(4)(A) Except as provided in paragraphs (1) through (3) of this subsection, rulemaking under this subsection shall be in accordance with the procedures specified in section 553 of Title 5 for rulemaking not on the record.

(B) Nothing in this subsection shall be construed to impair or limit the Commission's power to make, or to modify or alter the procedures the Commission may follow in making, rules and regulations pursuant to any other authority under this chapter.

(C) Any amendment to the rules of a self-regulatory organization made by the Commission pursuant to this subsection shall be considered for all purposes of this chapter to be part of the rules of such self-regulatory organization and shall not be considered to be a rule of the Commission.

(5) With respect to rules described in subsection (b)(5) of this section, the Commission shall consult with and consider the views of the Secretary of the Treasury before abrogating, adding to, and deleting from such rules, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor.

§ 21, 15 U.S.C. § 78u. INVESTIGATIONS AND ACTIONS

(d) Injunction proceedings; authority of court to prohibit persons from serving as officers and directors; money penalties in civil actions

(1) Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter, the rules or regulations thereunder, the rules of a national

securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

* * * * *

(e) Mandamus

Upon application of the Commission the district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this chapter, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, (2) any national securities exchange or registered securities association to enforce compliance by its members and persons associated with its members with the provisions of this chapter, the

rules, regulations, and orders thereunder, and the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.

(f) Rules of self-regulatory organizations

Notwithstanding any other provision of this chapter, the Commission shall not bring any action pursuant to subsection (d) or (e) of this section against any person for violation of, or to command compliance with, the rules of a self-regulatory organization unless it appears to the Commission that (1) such self-regulatory organization is unable or unwilling to take appropriate action against such person in the public interest and for the protection of investors, or (2) such action is otherwise necessary or appropriate in the public interest or for the protection of investors.

54 940